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PRINCE AKIHITO.
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NATIONAL INTELLIGENCE ESTIMATE

NUMBER 41-60

(Supersedes NIE 41-58)

PROBABLE DEVELOPMENTS IN JAPAN

Submitted by the
DIRECTOR OF CENTRAL INTELLIGENCE

The following intelligence organizations participated in the preparation of this estimate: The Central Intelligence Agency and the intelligence organizations of the Departments of State, the Army, the Navy, the Air Force, and The Joint Staff.

Concurred in by the
UNITED STATES INTELLIGENCE BOARD

on 9 February 1960. Concurring were The Director of Intelligence and Research, Department of State; the Assistant Chief of Staff for Intelligence, Department of the Army; the Assistant Chief of Naval Operations for Intelligence, Department of the Navy; the Assistant Chief of Staff, Intelligence, USAF; and the Director for Intelligence, The Joint Staff, and the Director of the National Security Agency. The Atomic Energy Commission Representative to the USIB, the Assistant to the Secretary of Defense, Special Operations, and the Assistant Director, Federal Bureau of Investigation, abstained, the subject being outside of their jurisdiction.

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TABLE OF CONTENTS

	<i>Page</i>
I. INTRODUCTION	2
II. THE OUTLOOK	3
Foreign Policy	3
Political Prospects	5
Economic Prospects	6
Military and Security	6
US-Japan Security Relationship	6
ANNEX: PRESENT SITUATION AND TRENDS	
A. Political	
Kishi and the Liberal-Democratic Party	9
The Japan Socialist Party	9
The Japan Communist Party	10
B. Economic	10
C. Military	12
D. Foreign Policy	13
CHARTS:	
1. Selected Index of Japan's Economic Growth (Current Prices)	14
2. Balance of Payments, 1955-1958	14
3. Japan's Trade with the Sino-Soviet Bloc	15
4. Foreign Trade by Geographic Areas	15
5. Current Strengths of Japanese Self-Defense Forces	16

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PROBABLE DEVELOPMENTS IN JAPAN

THE PROBLEM

To analyze recent trends and to estimate probable developments in Japan over the next five years, with particular emphasis on Japan's international orientation.

CONCLUSIONS

1. Japan's critical dependence upon the US for defense and on the non-Communist world for trade will continue to be a powerful deterrent to any significant shift in Japanese foreign policy. Assuming ratification of the US-Japan Treaty of Mutual Cooperation and Security—which we believe to be likely—and no major economic reverses, Japan's foreign policy will probably remain essentially unchanged over the next two or three years. (Paras. 12, 16-17)

2. Under the revised security treaty, the US will probably be able to maintain a substantial military position in Japan. Despite continued left-wing opposition to US forces and bases in Japan, and the dependence of these bases upon Japanese labor for effective operations, we believe that the US will be able to use them for logistical support of security actions in the Far East. The Japanese Government probably would not agree to the launching of combat operations from the bases

unless it were convinced that the hostilities involved a critical threat to Japan's security. (Paras. 37-38)

3. It is highly unlikely that Japan will consent to the introduction of nuclear weapons into Japan during the period of this estimate. Except in an extreme emergency such as a direct threat of attack on Japan itself or, possibly, as a last resort to keep South Korea from falling before a Communist invasion, it is virtually certain that Japan would not agree to permit the launching of nuclear strikes from bases in Japan. (Para. 39)

4. A key factor in Japan's international orientation is the state of the economy. The economic outlook for Japan is good, assuming continued high levels of foreign trade, particularly with the US. A prolonged economic recession would probably create strong pressures within Japan for expanded relations with the Bloc, particularly Communist China. (Paras. 13, 28-30)

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5. Under any government an important Japanese foreign policy objective will be the improvement and, eventually, the normalization of relations with Communist China. Japan will probably make no significant overtures in that direction so long as Communist China continues its hostility toward the Kishi government or insists upon the loosening of US-Japanese ties and the acceptance of Peiping's claim to Taiwan as the price for improved relations. However, if Peiping were to reduce its demands and adopt a conciliatory approach, Japan would probably agree to Chinese Communist offers to expand trade and other relations. If Communist

China were admitted to the UN, or if other major nations were to recognize Peiping, Japan would probably feel a strong compulsion to recognize Peiping, although it would probably seek US acquiescence. (Para. 18)

6. There is widespread, but at present quiescent, neutralist sentiment in Japan. This sentiment could increase rapidly if the Japanese came to believe that US deterrent power could not prevent Communist aggression. Soviet rocket and space achievements have already raised some doubts on this score where none existed two years ago. (Para. 20)

DISCUSSION

I. INTRODUCTION

7. Japan is the most dynamic of the non-Communist states of Asia. Its economy is expanding at a rapid pace; its social structure is undergoing significant change; and its foreign policy is developing along lines of greater independence and self-reliance. Because Japan is still dependent upon the US for defense and on the non-Communist world for economic opportunities, its foreign policy is based upon the maintenance of close ties with the US and the West. Moreover, Japan has achieved remarkable results in almost every field of endeavor during the past 15 years and, although the nation is not committed by tradition to any fixed orientation in world affairs or wedded to Western patterns of political behavior, in broad outline the present form of parliamentary democracy and Japan's alignment with the West are supported by the majority of the Japanese people.

8. Many of Japan's historic national values and traditions were destroyed or weakened by military defeat, occupation, and foreign imposed reforms. The process of integrating old and new values is not yet complete and many

uncertainties remain in the highly complex Japanese society.

9. Japan is enjoying a period of prosperity which transcends anything it has previously experienced. Its economy has proved capable of impressive rates of expansion. However, certain basic facts remain: Japan is poor in natural resources; it still has a serious population problem; and its economy is highly vulnerable to international economic conditions over which the Japanese have no control.

10. Moreover, the political structure is far from stabilized. Most of the population, particularly the peasants and businessmen, is conservative in outlook. It is upon this element that the governing Liberal-Democratic Party (LDP) bases its strength. There is a sizable, restless, radical element, comprising about one-third of the electorate, among organized labor, intellectuals, and students from which the large Japan Socialist Party (JSP) and the smaller Japan Communist Party (JCP) draw their followers.

11. The most significant political conflict is not between the radicals and conservatives, but among the leaders of the various factions

of the conservatives, many of whom have shown political irresponsibility in their intra-party struggles for power. In seeking to advance their political careers, few are restrained by party discipline or by the broader considerations of Japan's internal stability or international position. Although the leaders of all factions of the Liberal-Democratic Party appear to recognize the necessity of close ties with the West, they do not hesitate to exploit foreign policy issues for personal advantage. The Prime Minister is subject to continual attack from Socialists and Communists on the one hand and, on the other, is constantly undermined by the aspirants for his job among the faction leaders of his own party. The press keeps up a rapid drumbeat of bitter and sweeping criticism of successive Japanese governments. Consequently, the position of a Prime Minister such as Kishi, who is seeking specific changes in important internal matters and pursuing a dynamic foreign policy, is especially precarious.

12. During the next 12 months, Kishi and his government will face some very difficult tasks. The most important will be the ratification of the revised US-Japan security treaty and related agreements which is now scheduled for Diet debate in the spring of 1960. The issues involved bear directly upon many of the most sensitive aspects of Japanese politics and public susceptibilities. The outcome of the debates will not only affect the political future of Kishi, a major proponent of close ties with the US, but will also have an important bearing on the entire range of US-Japan relations.

13. There are several factors which will continuously affect Japan's international orientation. Primary among these is the state of the economy. Japan is completely dependent upon foreign trade and international market conditions for its economic well-being. Consequently, any Japanese government must place first emphasis upon maintaining the best possible trading position. Any significant economic reverse, especially if accompanied by a denial of economic opportunities or discrimination against Japan by the West, would tend to strengthen the hand of the

nonconservative political groups and to increase pressures on the government to cut its defense expenditures and seek commercial and political rapprochement with the Bloc, especially Communist China.

14. There is also Japan's proximity to an increasingly powerful Communist China. The Japanese people in general have a considerable sense of rapport with the Chinese, based upon historic, cultural and commercial ties. Virtually all Japanese leaders believe that eventually Japan must normalize relations with Communist China. Another consideration is the widespread neutralist sentiment in Japan. Among the nonleftist elements of the population, this is based upon an extreme sensitivity to nuclear weapons, a sense of military inadequacy in the East-West conflict, and a desire to concentrate upon economic improvement.

15. Working contrary to these considerations are the factors that favor Japan's continued alignment with the West—economic prosperity based almost entirely on trade with the non-Communist world; the need to continue to rely on the US for defense; Communist China's intransigent attitude toward Japan; a deep suspicion of the USSR; and a reviving national pride.

II. THE OUTLOOK¹

Foreign Policy

16. Japan's critical dependence upon the US for defense and trade will continue to be a powerful deterrent to any significant shift in Japanese foreign policy. Assuming ratification of the US-Japan security treaty and no major economic reverses, the broad outlines of Japan's foreign policy will probably remain essentially unchanged over the next two or three years. However, the nature and strength of the US-Japan relationship will depend in large measure upon the US response to Japan's urge for recognition as a responsible, mature power in world affairs and upon Japan's success in expanding its trade with the non-Communist world.

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¹ See Annex for an analysis of the Present Situation and Trends.

17. The pattern of US-Japanese relations will also be affected by domestic political developments in Japan. The current high degree of cooperation with the US reflects the leadership of Prime Minister Kishi, who appears to be the most aggressive advocate of close US-Japanese ties among the leading Japanese political figures. Even under Kishi, however, Japan will not be guided wholly by US wishes if its own domestic and international interests appear to dictate a different course. If Kishi should be replaced, working relationships between the US and Japan might become more difficult, especially if the transfer of power were accompanied by acute dissension among the conservatives. However, we do not believe that any other likely conservative Prime Minister would alter drastically the broad outlines of Japanese foreign policy.

18. Under any government an important objective of Japanese foreign policy will be the improvement and, eventually, the normalization of relations with Communist China. We do not believe that Japan will make any significant overtures to gain this objective so long as Communist China continues its undisguised hostility toward the Kishi government, or so long as it insists on the loosening of US-Japanese ties and the acceptance of Peiping's claim to Taiwan as the price for friendship. If Communist China were to reduce its demands and adopt a conciliatory approach, domestic pressures would probably force Japan to move rapidly to expand trade and other relations which, in turn, would increase pressures for recognition. If Communist China were admitted to the UN, or if other major nations, such as Canada or France, recognize Peiping, Japan would probably feel a strong compulsion to recognize Peiping, although it would probably seek US acquiescence. Although increasingly aware of the difficulties involved, Japan will probably continue to hope that some kind of "two Chinas" solution will be found which would keep Taiwan non-Communist.

19. Although Japan's trade and cultural relations with the USSR will probably expand gradually, the relationship between the two countries is unlikely to advance beyond that

of correct formality. If the USSR reverts to a menacing and tough approach toward Japan, Japan's attitude will almost certainly harden. There is a strong current of hostility toward Russia in Japan, and the issues of Soviet occupation of the South Kuriles and restrictions on Japanese fishing are formidable, although not insurmountable, obstacles to a rapprochement.

20. Beneath the surface in Japan there is a strong strain of neutralist sentiment which is shared to some degree by all elements of the population. Most Japanese support the Kishi government's forthright rejection of neutralism as a safe or realistic course for Japan to follow under present world conditions. However, neutralist sentiment could be increased to the point of threatening Japan's close alignment with the West if the Japanese come to believe that US deterrent power could not prevent aggression. Soviet rocket and space achievements have already raised some doubts on this score where none existed two years ago. Neutralist sentiment in Japan would also be stimulated by the appearance of a *détente* between the West and the Soviet Union.

21. No significant or lasting improvement in the bitter relations between Japan and South Korea is likely so long as Rhee is in control in South Korea. The Japanese have probably come to the view that negotiations with South Korea under Rhee serve little or no purpose, but they will probably continue to seek through diplomatic channels some basis for future agreement.

22. In its relations with the Afro-Asian area, Latin America and the Middle East, Japan will continue to place primary emphasis upon economic diplomacy, seeking to expand its markets and sources of raw materials. In dealing with these areas, and in the UN, Japan will continue to characterize itself as primarily an Asian country and to stress its freedom from US and western influence. At the same time, however, Japan to an increasing extent will regard itself as a world industrial power sharing a basic mutual interest with the major industrial states of the world.

23. *Political Prospects.* During the next five years, the Japanese Government will almost certainly remain in the hands of moderate conservatives who will probably seek no drastic change in Japan's domestic or security policies. Barring a prolonged economic recession, successive conservative Japanese governments will probably continue to have the support of a large majority of the Japanese people. Within this broad trend, however, considerable political changes are possible.

24. Prime Minister Kishi's political future is uncertain. He need not call general elections until 1962 and his prestige has risen following his recent visit to Washington to sign the security treaty. He has announced his intention to run for another two year term as President of the LDP (an office which carries with it the prime ministership) in the party elections scheduled for January 1961. The political power and leverage which accrue to the Prime Minister, give Kishi a considerable advantage over his rivals. His opponents are competing among themselves and have shown no signs of developing the issue, the unity, or the support necessary to bring him down. His rivals, however, are restless and impatient and Kishi himself is not a particularly popular figure within the LDP or with the public at large. If he desires to remain in power, he will have to call upon all of his political skill to avoid the pitfalls that lie ahead in the Diet struggle over ratification of the new security treaty, the probable subsequent reorganization of the cabinet and party leadership, and the party election. Should Kishi leave office, voluntarily or otherwise, the transfer of power to a new regime would probably involve a bitter struggle for power among several aspirants, including Foreign Minister Fujiyama, Finance Minister Sato (Kishi's brother), Minister of International Trade and Industry Ikeda, and Takeo Miki and Ichiro Kono, both former cabinet ministers.

25. The two party system as it has developed since 1955 (when the left and right wing Socialists formed the Japan Socialist Party and the Liberal and Democratic Parties merged) was disrupted when right wing Socialists, including 52 Diet members, defected from the

JSP in late 1959 and early 1960 to form the new Democratic Socialist Party (DSP). The ultimate fortunes of the new party will depend on its ability to attract additional defectors from the JSP, enlist the support of small businessmen and farmers who now back the LDP, and weaken the hold of the JSP and *Sohyo* on organized labor. Conservative unity is still not firmly established and a split in the LDP is possible, although we do not believe it likely.

26. Despite recent defections and election defeats, the Japan Socialist Party, with its disciplined labor support and its ability to influence public opinion, will continue to be a major force on the Japanese political scene, capable of severely harassing the conservative government and restricting its freedom of action. The DSP and the JSP will probably cooperate on many major issues, and the policies of the Socialists will reflect the attitudes and receive the support of large segments of the Japanese people. However, so long as the Socialists remain split, with the JSP essentially a class party largely dominated by organized labor, the Socialists will probably not be able to attract much more than the one-third of the electorate which has hitherto supported them. The Socialists could attain power in the next five years only if the conservative alignment were to disintegrate, or if there were to occur a prolonged economic recession which the conservatives proved unable to cope with. Neither of these developments appears likely.

27. The Communists, through their "united front" activities and their penetration of labor unions, mass media, teacher and student groups, will continue to exercise a substantial influence on Japanese opinion, and will retain their capabilities for violence and sabotage. If they soft-pedal their revolutionary goals and act in concert with the Socialists and other "peace-loving" organizations, the Communists may regain gradually some of the respectability which they lost in the past with their violent tactics. However, except in the event of an economic disaster or near-breakdown of the social order, they are unlikely to become a significant political force in their own right.

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28. *Economic Prospects.* Japan's economic prospects are dependent upon international economic and commercial developments, and particularly upon continued access to the US market. Japan's efforts to attain the level of exports necessary to sustain expanding industrial production, a rising standard of living, and adequate foreign exchange reserves will be centered on the US. In response to US pressure, Japan has agreed to liberalize to some extent its present restrictions against the importation of selected manufactured goods and industrial materials, and it will continue its attempts, by voluntary export controls, to forestall the erection of US trade barriers against Japanese imports. It will also seek to persuade the US to maintain its present ICA and other offshore purchase programs because special dollar earnings from this source and from outlays by and for US troops in Japan still mean the difference between profit and loss in Japan's external accounts.

29. Assuming the current level of world prosperity and continued access to a "fair share" of the US market, the Japanese economy will continue to grow. In 1959 the economy recovered rapidly from the recession of 1958, and it is likely that GNP in JFY 1960 will increase about 6.5 percent. Japan's high rate of investment will probably continue and be concentrated in the basic industries, steel, electric power, transportation, chemicals, and machinery. The government will probably not hesitate to apply its controls—on credits, investments and imports—if the rate of investment again threatens to result in excess production and a speculative increase in imports.

30. The issue of trade with Communist China will probably not become an acute political problem as long as the Japanese economy continues to prosper, and Peiping continues its antagonistic policies toward the Japanese Government. Japan will seek actively to expand its trade in all promising markets, including the USSR, but for the period of this estimate, at least, trade with the US will continue to be the key to Japan's economic well-being and the point of primary emphasis in its trade efforts. A major economic reverse would create strong pressures within Japan

for expanded relations with the Bloc, particularly Communist China.

31. *Military and Security.* Japan will continue to depend primarily on US deterrent strength for its defense. At the same time, the trend toward acquiring and developing technically advanced conventional weapons will continue and probably accelerate, provided there is no significant economic recession and despite a considerable amount of popular opposition. Although at the end of the period of this estimate Japan will probably have a well-trained and efficient defense force, it will still have only limited ability to defend Japan against major attacks.

32. Japan will probably make substantial progress in research and development of nuclear energy for peaceful uses within the period of this estimate. Japan may eventually develop its own nuclear weapons, although not within the period of this estimate.

33. *The US-Japan Security Relationship.* The revised US-Japan security treaty and related agreements were presented to the Japanese Diet on 5 February 1960. It is likely that the ensuing Diet debate over ratification will be one of the most bitter and protracted in post-war Japanese history. The Japan Socialist Party and its well-organized supporters, faced with the certainty that the treaty will be ratified if the Diet vote follows party lines, will probably use demonstrations, strikes, parliamentary obstructionism, and possibly a Diet boycott to prevent or delay ratification. However, their extremism will be tempered by the moderate attitude of the Democratic Socialist Party. The Japan Communist Party will use its influence over segments of organized labor, students and front groups to attempt to rally public opposition to ratification. The brittle unity of the Liberal-Democratic Party will be under severe strain and Kishi will probably have a very difficult time maintaining party discipline. Although we believe that he is likely to achieve Diet ratification, a general election on the issue is possible.

34. The major targets for the antitreaty forces will probably be the duration of the treaty (10 years), the limitation of the treaty area to

Japan proper, the rights of the US to use its military bases in Japan in a conflict in which Japan is not directly involved, and the question of introduction of nuclear weapons into Japan by the US.

35. The US has met Kishi's most urgent requirement by agreeing that the US will consult with the Japanese Government before making major deployments of forces into Japan, including major changes in equipment (specifically the introduction of nuclear weapons), or before using military bases in Japan to conduct combat operations directly from Japan. The language of the present Administrative Agreement governing the status of US forces in Japan will be modified somewhat to remove its occupation flavor and to bring it more closely into line with the NATO Status of Forces Agreements, and the requirement that Japan make an annual contribution in yen to the support of the US forces in Japan has been eliminated.

36. The terms of the revised security treaty do not affect the status of US bases on Okinawa. However, Japan will continue to seek an increasing degree of participation in Ryukyuan affairs, and the presently quiescent issue of US administration of the islands may again become a source of friction in US-Japan relations should major issues arise in US relations with the islanders.

37. With the ratification of the security treaty, the US will probably be able to maintain a substantial military position in Japan. Despite the provisions of the treaty, however, the unimpaired use of Japanese bases for logistical purposes in support of security actions elsewhere in the Far East is not certain: for example, the operation of US bases being highly dependent upon Japanese labor, strikes and sabotage could greatly reduce their effectiveness for logistical support. The presence of US forces and bases in Japan will continue to meet with strong opposition, particularly from the Socialists, Communists, and the large elements of organized labor which are under left-wing domination. Moreover, in a time of crisis in which Japan itself were not immediately threatened, it is possible that another Japanese Government might interpret the

treaty narrowly or press for its revision, particularly if it encountered strong internal opposition to the US use of the bases. However, on balance, we believe that the US would be able to use Japanese bases for logistical purposes in support of security actions elsewhere in the Far East during this period, although the Japanese Government would expect to be informed in advance of our intentions.

38. The Japanese regard the consultation arrangements provided in the new treaty as designed primarily to prevent Japan from becoming involved in hostilities against its will. The Japanese Government probably would not agree to the use of US bases in Japan to launch combat operations involving conventional weapons against targets elsewhere in the Far East unless it were convinced that the hostilities involved were a critical threat to Japan's immediate or future security. Approval for such combat operations would be almost certain in the event of a Communist attack on the Republic of Korea, and probable in the case of Taiwan itself. However, the Japanese would base their decision on their own analysis of the situation, carefully balancing the importance of the threatened area to Japan's own security against the likelihood of retaliation against Japan.

39. It is highly unlikely that the Japanese Government will consent to the introduction of nuclear weapons into Japan during the period of this estimate. Except in an extreme emergency such as a direct threat of attack on Japan itself or, possibly, as a last resort to keep South Korea from falling before a Communist invasion, it is virtually certain that Japan would not agree to permit the launching of nuclear strikes from bases in Japan.

40. If Prime Minister Kishi should fail to obtain approval of the new security treaty, the US military position in Japan would be seriously threatened. If, as is probable, a conservative government remains in power, US bases could probably be maintained substantially in their present form for a year or two, because no conservative government would be willing to risk sacrificing the economic and other benefits Japan derives from its associ-

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ation with the US by demanding a withdrawal of US forces. However, failure to secure ratification of the treaty would impair all aspects of the US-Japan relationship, and would result in a gradual deterioration of our base position. The speed of this deterioration would depend upon the reaction of the US to the defeat of the treaty, the circumstances under which it was brought about, and the willingness of those who succeeded Kishi to seek a new basis for continuing the relationship. Whatever the circumstances, however, defeat of the new security treaty would lead the public to expect the present military arrangements to be altered, and the use of US bases to be circumscribed by additional restrictions.

41. An announcement by Communist China that nuclear weapons were stationed on Chinese soil would have a profound effect in Japan. We believe it likely that such an announcement would greatly increase neutralist tendencies among the Japanese people and public pressures upon the government to seek an understanding with Communist China. However, if Kishi or some other Prime Minister of similar convictions and courage were at the head of the Japanese Government, the government might agree to the stationing of US nuclear weapons in Japan, but not without some form of Japanese participation in control of their use. Even so the Japanese Government would probably have to move against strong public opposition.

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ANNEX

PRESENT SITUATION AND TRENDS

A. Political

1. *Kishi and the Liberal-Democratic Party.* Prime Minister Kishi recovered from the Police Bill defeat which nearly led to his political eclipse in late 1958, and his position has been strengthened by the results of the municipal and Upper House elections in the spring of 1959.² The elections, in which Kishi's foreign policy was a major campaign issue, marked the first time since the end of the occupation that the upward trend in the Socialist's popular vote was reversed. Although the Liberal-Democratic Party did little more than hold its own; the election was considered to be a major victory for the conservatives and a vote of confidence for Kishi. This has enabled Kishi to hold to his policy of no official contacts with Communist China and to move forward with the revision of the US-Japan security treaty.

2. Nevertheless factional rivalries within the LDP still constitute a threat to Kishi's position. In forming a new cabinet following the elections Kishi was rebuffed in his efforts to engage the responsibilities of all the major factional leaders and was forced to rely primarily on a new factional grouping led by his brother, Finance Minister Eisaku Sato, and Minister of International Trade and Industry Hayato Ikeda. This arrangement left

important segments of the party (including that led by Ichiro Kono, a bitter rival of Ikeda and hitherto a strong Kishi supporter) outside the cabinet and the party hierarchy. Although temporarily quiescent in recent months, these rivalries will almost certainly come to the surface again as the various factional leaders seek opportunities to upset Kishi's leadership. Thus far, Kishi, firmly supported by the business community and with substantial financial resources at his disposal, has been able to beat down challenges to his authority and to maintain a reasonably firm degree of party discipline. His task has been made easier by the fact that his rivals are also competing sharply among themselves, and have been unable to form an anti-Kishi "united front." After the security treaty is ratified, it is likely that Kishi will attempt to reshuffle his cabinet and the hierarchy of the Liberal Democratic Party to further strengthen his position.

3. *The Japan Socialist Party.* The position of the opposition Japan Socialist Party deteriorated during 1959. In March, a Socialist mission to Peking designed to play on popular enthusiasm for normalization of relations with Communist China, boomeranged. The mission joined in a joint communique with Chou En-lai condemning US imperialism. This cost the Socialist Party considerable public support. The poor showing in the Upper House elections, even in the Socialist's urban strongholds, aggravated the long-standing intraparty conflict between the dominant left-wing, which is tied to the Communist-infiltrated General Council of Labor Unions (SOHYO), and the minority right wing which advocates a less militant and more moderate program which might appeal to Japan's conservative masses.

² Of the 467 Lower House seats, the LDP holds 288, the Socialists 165 and the Communists one; there are two independents and 11 seats are vacant. The LDP has 136 of the 250 Upper House seats and is supported by almost all of the 25 independents; the Socialists have 84 Upper House seats, the Communists three, and two are vacant. The Socialist totals include the 54 Diet members (38 in the Lower and 16 in the Upper House) who seceded from the JSP in late 1959 and early 1960 to form the Democratic Socialist Party.

4. In October, after a bitter debate in the party convention, this conflict led to the defection of 33 right wing Socialist Diet members under the leadership of Suehiro Nishio. Additional defections followed, and when the new Democratic Socialist Party was formed in late January, under Nishio's chairmanship, it included 54 Diet members and had the full support of *Zenro*, Japan's second largest trade union confederation. The Socialist Party defections reflected not only right wing dissatisfaction with the extremist policies of the JSP but also what appears to be a growing demand for a party that lies somewhere between the present conservative and JSP camps. Whether or not the DSP in time gains a firm foothold as a major political force, the new party may well tend to restrain JSP extremism and also to act as a moderating force on the conservatives. Meanwhile JSP leaders and their *Sohyo* colleagues, unfazed by the election results continue on their extreme leftward course. Their foreign policy objectives, including abolition of the US-Japan security treaty and the eventual neutralization of Japan, continue to be virtually undistinguishable from those of the Communists. The participation of the JSP and *Sohyo* in a demonstration at the Diet 27 November in the course of which demonstrators forced their way past police into the Diet grounds, earned them extensive public criticism and probably helped to enhance the public standing of the new party movement.

5. *The Japan Communist Party.* The Japan Communist Party has an estimated membership of about 70,000 and it has attracted about one million votes of a total 40 million (about 2.6 percent) in national elections. However, it controls only one seat in the Lower House and three in the Upper House of the Diet. The party has heavily infiltrated intellectual circles, student groups, and leftist teachers, government employees, and railway workers unions. As a consequence, it exerts considerable influence. However, the party is plagued by factional cleavages based largely on ideological differences. The party has substantial capabilities for mass violence and sabotage. An estimated 30 to 40 thousand of its members are hardcore Communists who would probably remain loyal to the party under try-

ing and hazardous circumstances. Probably half of this number would engage in illegal and covert activities if ordered to do so.

B. Economic

6. Japan recovered quickly from its 1957-1958 economic recession once the upward trend in international trade was resumed.³ By mid-1959 Japan's industrial production was more than 25 percent above the comparable period of 1958. Foreign exchange reserves, which slipped to about \$450 million in September 1957, climbed to a postwar high of nearly \$1.3 billion by November 1959.⁴ High levels of activity now characterize almost all areas of the manufacturing sector of the economy. Japan's rapid transition from recession to expansion during the past 18 months demonstrates the dynamic aspect of the economy. However, Japan's recession and recovery also demonstrate the precarious balance of its economy, its heavy dependence upon favorable foreign trade conditions, and its sensitivity to external developments over which the Japanese have no control.

7. Although Japan is at present enjoying a high rate of industrial expansion and prosperity, it faces a number of long-range and permanent economic problems. Japan's balance of payments position, although dramatically improved, will probably always be precarious because of the need to import virtually all the raw materials to keep its industry going and slightly less than 20 percent of its food requirements.⁵ In three periods of mild recession the government has demonstrated its ability to cushion the effects of an international economic downturn by controlling the domestic money supply, restricting imports, and regulating credit. However, it probably could not maintain an austere program over a long period of time without serious economic and political consequences. The recent improvement in Japan's economic position has led its trading partners to press

³ See Table 1, Selected Indexes of Japan's Economic Growth.

⁴ Japan's year end foreign exchange reserves in million US dollars were: 1956—451; 1957—525; 1958—861; and November 1959—1,291.

⁵ See Table 2, Balance of Payments, 1955-1958.

hard for an end to Japanese import and payments restrictions.

8. In addition, Japan has sizable foreign obligations. It is expected to pay out a total of nearly \$2 billion in grants and loans over the next 20 years under its reparations agreements. Also it must service and repay almost \$150 million in PL 480 loans to the US and about \$250 million on IBRD loans granted for steel, transportation and electric power projects. It must provide its share of funds for the IDA and the expanded requirements of the IMF and IBRD. It must finance its capital exports on terms which are as attractive as its international competition. In addition, the US is seeking to reopen negotiations to settle Japan's Government and Relief in Occupied Areas (GARIOA) debt, for about \$800 million.

9. Another long-term economic problem is how to provide employment for a labor force that will increase at the rate of more than one million annually for the next decade. Although the decline in the birth rate, which began in the early 1950's, will reduce this pressure in the future, Japan has always been plagued by widespread underemployment, even in times of prosperity.⁸ Equally important, the Japanese Government will be under heavy pressure to increase living standards. Although the Japanese people are living better than at any time in their modern history and have the highest living standard in Asia, they expect a steady improvement commensurate with Japan's status as one of the world's leading industrial nations.⁹ This na-

⁸ The Japanese Government has successfully attacked Japan's population problem through a vigorous program of education and free medical service. As a result, Japan's birth rate dropped from 34.3 per thousand in 1947 to a low of 17.2 in 1957. Even so, the population is still increasing. The rate of increase in the 1952-1958 period averaged 1.2 percent and the total population, estimated at 92.7 million in mid-1958, is expected to exceed 96 million by the end of 1965.

⁹ For the purposes of comparison: In 1958, Japan's per capita income was approximately \$258, that of West Germany was \$721.7; Japan's per capita GNP was \$305, West Germany's \$972; Japan's foreign exchange reserves at the end of that year were \$861 million, West Germany's \$6,321 million.

tional sentiment has compelled Japanese governments to ease taxes on individual incomes, to invest heavily in economic development and social welfare programs, and to limit military expenditures.

10. In addition Japan is facing increasingly stiff competition in international markets from other exporting nations. Japan has devoted considerable effort to expanding trade with underdeveloped areas, particularly South and Southeast Asia. Although this effort has brought some limited success, the Japanese are well aware that the trade potential of these areas is limited by their lack of financial resources and by their inability, at their present stage of economic development, to absorb a large volume of imports. For several years, Japan has advocated a joint US-Japanese regional economic development scheme for Southeast Asia, with the expectation that, in time, the purchasing power of the area would be increased, making possible expanded Japanese exports. However, the Japanese clearly regard the underdeveloped areas as secondary to the US as a potentially expanding market. In the period 1954 to 1958, non-Communist Asia's share of total Japanese exports declined from 48 to 35 percent, while the US share increased from 17 to 24 percent.

11. Japan's search for raw materials and markets accounts in large part for the attraction of "normalizing" relations with Communist China apparent among practically all elements of the Japanese population. To date, Japan's trade with the Communist Bloc has been of marginal economic importance, representing only 2 to 4 percent of Japan's trade. This trade has declined even below these levels since May 1958 when Communist China, which accounted for about 75 percent of Japan's trade with the Bloc suspended trade with Japan, largely for political reasons. The current economic prosperity in Japan has reduced the domestic pressure for trade with Communist China. However, trade with the USSR has increased rapidly, although it is still only about one percent of Japan's total trade.¹⁰

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¹⁰ See Table 3: Japan's Trade with the Sino-Soviet Bloc.

12. The US is Japan's most important trading partner, accounting for 24 percent of Japan's exports and 35 percent of its imports in 1958.⁹ During 1959, for the first time in the postwar era, Japan achieved a surplus in its merchandise trade with the US. Apart from its fear of an international business recession, Japan's greatest economic concern is that the upward trend in its exports to the US may be adversely affected by US restrictions on imports resulting from the recent appearance of a deficit in the US balance of payments position, or from pressures exerted by many US producers whose products compete with Japanese imports. The Japanese leaders, fearful of the possible economic and political consequences, are very sensitive to any indications that their access to the US market may be curtailed. Moreover, the Japanese are concerned by the downward trend in special dollar earnings which has resulted from the reduction in US troops stationed in Japan and a cutback in offshore procurement programs.¹⁰ Since World War II Japan has not achieved a surplus in its world trade accounts, and special dollar earnings have made the difference between profit and loss in Japan's international accounts.

2. Military¹¹

13. In the face of public suspicion and disapproval, the Japanese Government has proceeded, gradually but steadily, to build up its Self-Defense Forces. Despite considerable public reluctance and the opposition of the Socialist and Communist Parties, the Japanese Government is accepting the idea that Japan should carry an increasing share of the cost of its own defense. Between 1953 and 1959, Japan more than doubled its defense budget,

⁹ See Table 4: Foreign Trade by Geographic Areas.

¹⁰ The special dollar earnings are generated by US offshore procurement programs (purchases in Japan for third countries) and by outlays for and by US troops in Japan. Over the past few years Japan's income from this source was as follows: (in million US dollars) 1954—575; 1955—545; 1956—591; 1957—549; 1958—484; and January—September 1959—349.

¹¹ See Table 5: Current Strengths of the Japan Self-Defense Forces.

from about \$167 million to \$378 million. This still represents only about 10 percent of the national budget and less than two percent of GNP. Japan's Self-Defense Forces now number about 210,000 and the National Police Agency about 140,000. The government is now considering its military program for the 1960-1965 period. Under this program the defense budget would be doubled again in the next five years. Most of this increase would go to improvements in the quality of arms and equipment. First priority is the strengthening of Japan's air defense capabilities by acquiring improved radar equipment, converting the Air Self-Defense Force to century-series fighters, and acquiring a defensive ground-to-air and air-to-air missile capability. Second priority is to strengthen antisubmarine and mine warfare capabilities of the Maritime Self-Defense Force, and third priority is to improve the mobility of the Ground Self-Defense Force.

14. During the past year the training and capabilities of Japan's 162,000 man Ground Self-Defense Force have shown marked improvement. However, the ground forces are presently capable of conducting only limited defensive operations within Japan. The Japanese Air Self-Defense Force has made significant strides towards becoming an effective, modern air force. It has a personnel strength of about 24,000, and its aircraft strength is nearly 1,000, including 650 jets. The air force now has a limited capability to perform its missions of air defense and tactical support. The Japanese Maritime Self-Defense Force is still in a formative stage of development. Although this force is well-trained, the fleet is small.

15. The public revulsion against nuclear weapons continues unabated. However, the highly sensitive issue of nuclear weapons has been relatively quiescent during the past year, possibly because there have been no recent nuclear weapons tests in the Pacific. The Japanese public has accepted with equanimity the government's announced intention to acquire a defensive capability in ground-to-air and air-to-air missiles, a step which would have been vigorously denounced two or three

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years ago as a move toward introducing nuclear weapons into Japan.

D. Foreign Policy

16. Japan's international position and the pattern of its foreign policy have continued essentially unchanged during the past year. Japan remains closely aligned with the US and the West; in Southeast Asia, lingering hostilities toward Japan are disappearing and no longer constitute a major obstacle to Japan's expanding economic and diplomatic activities in that area; Japan has played an active and constructive role in the UN, thereby increasing its prestige and international stature; and Japan's relations with the Government of the Republic of China remain friendly. The major problem areas in Japan's foreign policy are its relations with the Communist Bloc and the serious state of Japanese-South Korean relations.

17. Both Communist China and the USSR are conducting vigorous campaigns to lead Japan toward neutralism. Particularly during the first part of 1959 the USSR maintained a steady flow of diplomatic notes, propaganda broadcasts, and public speeches attacking Kishi's foreign policy of close relations with the US and the negotiations for a revised US-Japan security treaty. Moscow warned that these policies were "pregnant with grave consequences" and urged neutralism for Japan. The USSR's cultural offensive is running in high gear with top flight Soviet artists performing throughout Japan before appreciative audiences. The USSR's scientific achievements have greatly enhanced Soviet prestige with the scientific and technically-minded Japanese. Moreover, Khrushchev's visit to the US, which was exhaustively covered by Japanese press and TV, appears to have made a strong and favorable impression in Japan. Nevertheless, Japanese leaders continue to fear and distrust the Soviet Union, which they regard as the major threat to Japan's security. Sensitive outstanding issues between the two are the Soviet Union's

continued occupation of the Southern Kuriles, Shikotan, and Habomai, and the increasingly stringent restrictions which the USSR imposes on Japan's northern fishing operation. Thus far the Japanese have declined to conclude a peace treaty with the USSR until Japanese territorial claims are recognized.

18. Communist China's intransigent behavior on the international scene during the past year and its crude efforts to upset the Kishi government by trade restrictions, propaganda, manipulation of the Japan Socialist and Communist Parties, and by bald threats, have disillusioned many Japanese and, in fact, increased public support for Kishi. Due primarily to Japan's current prosperity and the way in which Peiping overplayed its hand, domestic pressures on the Japanese Government to seek accommodation with Communist China have declined. As yet, however, the Japanese public does not appear to bear the same suspicion of the Chinese as they do of the Russians. Most Japanese, probably including Kishi and other key conservative leaders, believe that Japan must eventually arrive at some kind of modus vivendi with the Communist regime in China. With the conclusion of the revised US-Japan security treaty, many Japanese believe the next goal should be improved relations with Communist China.

19. Japanese-ROK relations are complicated by a residue of historical and cultural antagonisms which do not yield easily to the normal approaches of western-style diplomacy. Perhaps in no other area are specific issues so intertwined with questions of "face," "sincerity," and "responsibility."

20. There is no prospect for any real improvement in ROK-Japanese relations as long as Rhee is alive. Even after his death, the legacy of distrust and animus will persist. It is likely, however, that after Rhee's death Korea's leaders will view their relations with Japan on a more practical basis and that mutually beneficial economic ties will be permitted to develop.

Table 1
SELECTED INDEX OF JAPAN'S ECONOMIC GROWTH
 (Current prices)

	(Calendar years) 1952	1953	1954	1955	1956	1957	1958	1959	Plan JFY 1962
Gross national product	100	117	125	135	153	170	175	190	189
Gross national product per capita	100	115	123	131	147	161 est	161		
Industrial production	100	122	132	142	174	208	209	250 ²⁵	294
Exports (f.o.b.)	100	100	128	158	196	225	225	255	372
Imports (c.i.f.)	100	119	118	122	160	211	190	173	239
Percentage increase over previous year of:									
GNP		17	7	8	13	11	1		
Total production		20	8	8	23	16	1		
Industrial production		22	8	8	23	18	0		
Exports		0	28	23	24	15	1		
Imports		19	insig	3	31	22	-29		
Personal consumption as a percent of GNP	59.5	61.6	63.2	62.5	59.1	57.8	60.6		
Gross private investment as a percent of GNP	19.4	19.5	16.9	15.5	22.4	26.0	16.3		

Source: International Financial Statistics, International Monetary Fund.

Table 2
BALANCE OF PAYMENTS, 1955-1958
 (Calendar years; values in millions of US dollars)

	1955	1956	1957	1958	(January-June) 1959
Exports (f.o.b.)	2,006	2,482	2,857	2,870	1,524
Imports (f.o.b.)	-2,061	-2,613	-3,255	-2,501	-1,493
Trade Balance	-55	-131	-398	269	31
Transportation and Insurance (net)	-157	-316	-518	-176	-97
Government (net)*	510	505	468	403	175
Others (net)	-94	-117	-135	-136	-72
Balance Goods and Services	205	-59	-585	460	38
Capital Transactions					
Non-Government	31	33	36	39	22
Government (Reparations payments, short-term government borrowing, etc.)	-11	-5	-63	-234	-27
Balance	29	28	-29	-195	-5
NET TOTAL ALL CURRENT TRANSACTIONS	225	-31	-614	265	33

* Mainly special dollar receipts.

Source: International Financial Statistics, International Monetary Fund.

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15

Table 3
JAPAN'S TRADE WITH THE SINO-SOVIET BLOC
CALENDAR YEARS 1954-1958 AND JANUARY-JUNE 1959
(In millions of US dollars)

	1954	1955	1956	1957	1958	January- June 1959
Exports (f.o.b.)						
Communist China	19.1	28.5	87.3	80.5	50.6	1.9
USSR	insig	2.1	0.8	9.3	18.1	5.9
Others	4.9	8.8	5.2	6.8	6.3	2.9
Total	34.0	39.4	73.3	76.6	75.0	10.7
Percent of Japan's World Total	1.5	2.0	2.9	2.7	2.6	0.7
Imports (c.i.f.)						
Communist China	40.8	80.8	83.7	80.5	54.4	9.2
USSR	2.1	3.1	2.9	12.3	22.2	13.8
Others	5.3	5.2	15.9	17.8	9.6	4.8
Total	48.4	89.1	102.5	110.4	86.2	27.8
Percent of Japan's World Total	2.0	3.6	3.2	2.8	2.8	1.6

Table 4
FOREIGN TRADE BY GEOGRAPHIC AREAS
CALENDAR YEARS 1936, 1954-1958, AND JANUARY-JUNE 1959

	1936	1954	1955	1956	1957	1958	January- June 1959
Exports* (total in billions of US dollars)	0.9	1.6	2.0	2.5	2.9	2.9	1.5
Imports* (total in billions of US dollars)	1.0	2.4	2.5	3.2	4.3	3.0	1.7
Exports (in percent of total)							
Asia	64	49	42	41	40	37	35
Europe	8	9	10	10	12	11	10
North and Central America (United States)	18	21	27	26	26	29	36
South America	(16)	(17)	(22)	(22)	(21)	(24)	(29)
Africa	2	10	7	6	3	4	3
Australia and Oceania	5	8	10	16	17	14	13
Imports (in percent of total)	3	3	4	2	2	3	3
Asia	53	31	37	33	29	32	33
Europe	9	8	7	7	9	9	11
North and Central America (United States)	28	46	41	44	48	45	42
South America	(25)	(35)	(31)	(33)	(38)	(35)	(32)
Africa	3	7	4	4	4	3	2
Australia and Oceania	3	2	3	3	2	3	3
	6	6	7	9	10	9	9

Figures may not add to totals because of rounding.

* f.o.b.

* c.i.f.

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Table 5

CURRENT STRENGTHS OF JAPANESE SELF-DEFENSE FORCES

Ground Self-Defense Force

Personnel Strength: 160,000
 Principal components: 3 army headquarters
 6 infantry divisions
 4 combined brigades

Maritime Self-Defense Force

Personnel strength:
 General service 19,600
 MSDF air arm 6,000
 25,600

Ship strength:

Destroyer (DD)	13	Minesweeper, Ocean (MSO/MMC)	1
Submarine (SS)	1	Minesweeper, Coastal (MSC)	12
Escort Vessel (DE)	6	Minesweeper, Coastal (Old) (MSC(O))	9
Patrol Escort (PF)	18	Minesweeper, Inshore (MSI)	21
Submarine Chaser (PC)	9	Minesweeping, Boat (MSB)	1
Support Landing Ship (Large) (LSL)	23	Minelayer, Coastal (MMC/ARC)	17
Amphibious Vessels	7	Auxiliary Vessels	92
Motor Torpedo Boat (PT)	9	Service Craft	

Under Construction: DD-3, SS-3, PC-3, MSC-4.

Air arm strength: 194 aircraft (no jets).

Air Self-Defense Force

Personnel strength: 24,000

Includes 710 trained pilots.

Aircraft strength: 980 aircraft

Includes 630 jets, of which 1230 F-86F aircraft are in storage.

Tactical units:

- 4 Fighter squadrons (Jet, F-86F)
- 3 All-weather fighter squadron (Jet, F-86D)
- 3 Transport squadrons (Prop, C-46D)

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Document No. 1

RYUKYU ISLANDS
(OKINAWA)

JUNE 1960



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Ryukyu Islands
June 1960
Page 1

TABLE OF CONTENTS

I.	Basic Data	Page 2
	(Geography; Population; Language; Economy)	
II.	Government	Page 3
	(Background; Form; Political Parties; Communism; Stability)	
III.	Problems and Issues	Page 4
	(Land Use; Reversion to Japan)	
IV.	Biographic	Page 5
V.	Map	Page 6



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Ryukyu Islands
June 1960
Page 2

I. BASIC DATA

1. Geography: Island chain reaching from southern Kyushu, Japan, to within 65 miles of Taiwan. It consists of 848 square miles divided among 64 islands under US jurisdiction. The Amami group, in the northernmost portion of the Ryukyuan archipelago, was returned to Japan in 1953. The largest island, Okinawa, with 454 square miles, is the site of a major US military base, strategically located midway down the chain 400 miles from the Chinese Communist coast. The capital is Naha City, Okinawa. Naha's population is 220,000.
2. Population: 865,000 with about 683,000 on Okinawa Island. Basically Mongoloid with Caucasoid and Malayan admixtures. With 1,505 people to the square mile, Okinawa is one of the most densely populated non-metropolitan areas in the world.
3. Language: Ryukyuan, a variant of Japanese now unintelligible to anyone speaking only standard Japanese, is the popular language. Japanese is the official and commercial language, and 70% of the people are estimated to be bilingual.
4. Economy: Operates on two distinct levels: (1) the unviable basic domestic economy founded on subsistence agriculture, fishing, and forestry, which employ 49% of the working population of 396,000 but account for only 21% of national income; (2) the "military-base economy," which employs 13% of the working population and generates 36% of the national income. Receipts from exports (\$25.9 million in FY 1959), principally sugar, amount to about one fourth of expenditures for imports (\$98 million), but sales and services to US forces alone bring the Ryukyuan balance of payments into near equilibrium.




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Ryukyu Islands
June 1960
Page 3

II. GOVERNMENT

1. Background: American control of the Japanese Ryukyu Islands began after the battle of Okinawa in 1945 with the establishment of direct military government. When Japan regained independence in 1952, it retained "residual sovereignty" over the Ryukyus, but the US retained administrative authority.
2. Form: The government of the Ryukyu Islands (GRI), established in 1952, is semiautonomous, operating under the US Civil Administration for the Ryukyu Islands (USCAR) with a US-appointed Chief Executive, a unicameral legislature elected by universal adult suffrage, and a judicial branch. All essential powers rest with the USCAR, headed by the High Commissioner, Lt. Gen. Donald P. Booth. 
3. Political Parties: The conservative Okinawa Liberal Democratic Party was formed in October 1959 through a merger of conservative forces in order to gain a plurality (14 seats) in the 29-seat legislature. The moderate Okinawa Socialist Masses Party is second in representation (10 seats) and relies for support on strong grass-roots organization and popular appeal. The leftists are represented by the Liaison Council for the Protection of Democracy (Minren) and its parent party, the pro-Communist Okinawa People's Party. Subsequent to the ouster of OPP leader Kamejiro Senaga as mayor of Naha and the settlement of the Okinawan land issue, pro-Communist influence has diminished although Minren presently holds 5 seats in the legislature.
4. Communism: Party strength estimated at 75 hard-core and 200 to 300 active members.
5. Stability: The US Civil Administration and the presence of US forces provide a stable foundation for the Ryukyuan government.

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Ryukyu Islands
June 1960
Page 4

III. PROBLEMS AND ISSUES

Although the Ryukyuan economy has never been self-sustaining, continued presence of US forces and civil administration provides a stimulus to economic planning, growth, and a rising standard of living. Two related issues rise from this presence:

1. Land Use: Ryukyuans resent US occupation of 10.8% of the total arable land in the islands, and this issue provides the most visible irritant to relations between USCAR and the local population. Although agitation results from any US attempt to acquire additional land, the issue has been temporarily quieted by changing US payment from a lump sum for indefinite leases to rental fees negotiated every five years. Connected to this issue is pacifist objection to introduction of missiles, which also necessitates acquisition of additional land.
2. Reversion to Japan: Political developments are geared to obtaining the eventual reversion of the islands to Japan. A drive for increased governmental autonomy, currently taking the form of agitation for election of the chief executive, is an early step toward this goal. Reversion would permit Ryukyuans to gain full citizenship rights and therefore is widely desired, despite the realization that the present higher standard of living would deteriorate under Japanese administration.



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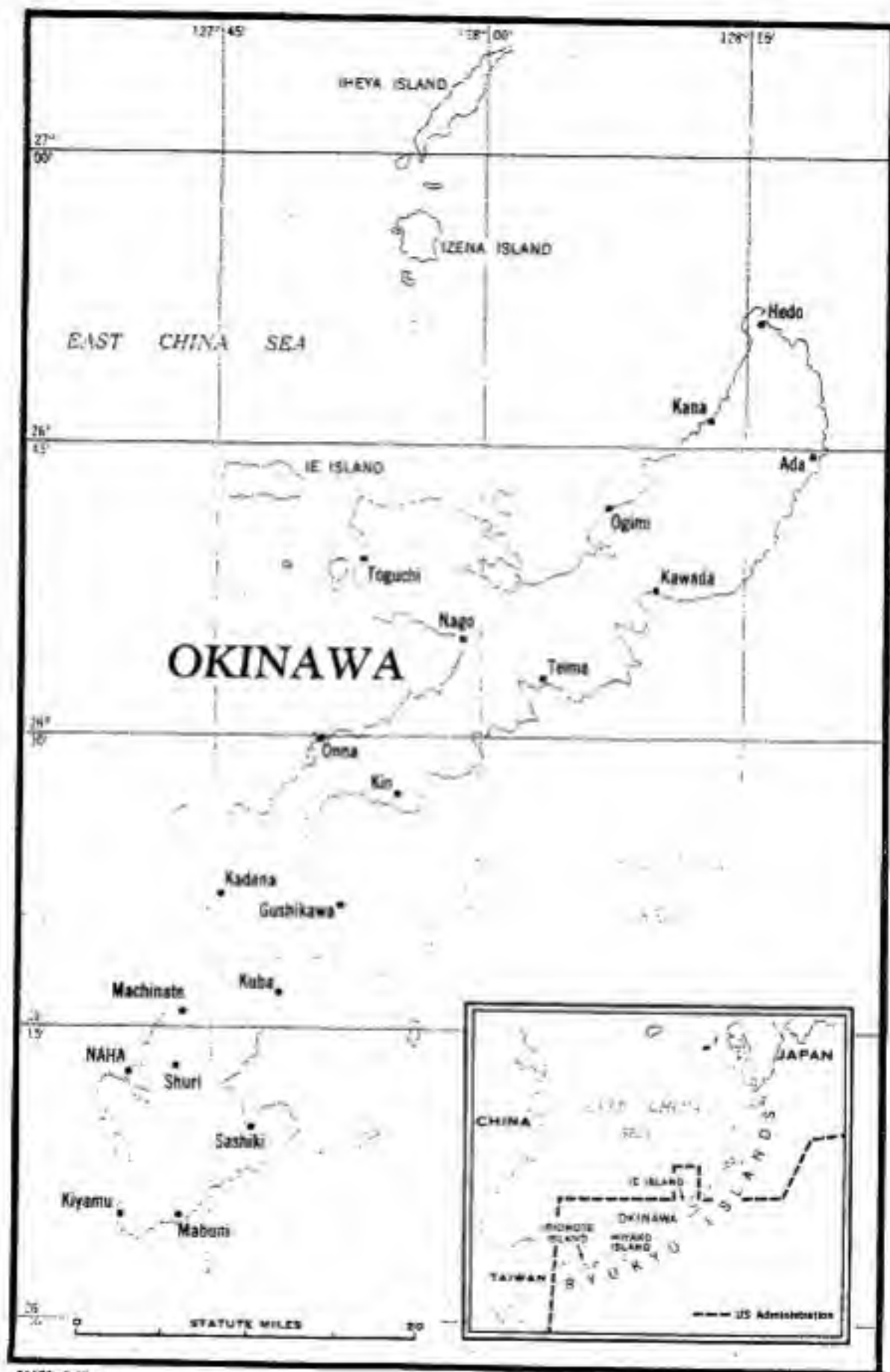
Ryukyu Islands
June 1960
Page 5

IV. BIOGRAPHIC

1. OTA, Seisaku: Chief Executive. He is a native of Okinawa with a distinguished career in the Japanese civil service. Before World War II, he served on two occasions as a judge in the Naha city courts. His highest position in the Japanese service was as civil administrator of the Pescadores Islands. He is one of the principal sponsors of the conservative Okinawa Liberal Democratic Party. Age: 56.



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NATIONAL INTELLIGENCE ESTIMATE
NUMBER 41-61
(Supersedes NIE 41-60)

PROSPECTS FOR JAPAN

Submitted by the
DIRECTOR OF CENTRAL INTELLIGENCE

The following intelligence organizations participated in the preparation of this estimate: The Central Intelligence Agency and the intelligence organizations of the Departments of State, the Army, the Navy, the Air Force, and The Joint Staff.

Concurred in by the
UNITED STATES INTELLIGENCE BOARD

on 7 February 1961. Concurring were The Director of Intelligence and Research, Department of State; the Assistant Chief of Staff for Intelligence, Department of the Army; the Assistant Chief of Naval Operations (Intelligence), Department of the Navy; the Assistant Chief of Staff, Intelligence, USAF; the Director for Intelligence, Joint Staff; the Assistant to the Secretary of Defense, Special Operations; and the Director of the National Security Agency. The Atomic Energy Commission Representative to the USIB, and the Assistant Director, Federal Bureau of Investigation, abstained, the subject being outside of their jurisdiction.

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PROSPECTS FOR JAPAN

THE PROBLEM

To analyze the political situation in Japan in the light of developments during 1960 and to estimate the general outlines of probable developments over the next year or so.

CONCLUSIONS

EO 12958 3.4(b)(1)-25Yrs
EO 12958 3.4(b)(6)-25Yrs
(S)

1. Although Japan will almost certainly remain aligned with the US over the next year or so, it will continue slowly to grow more assertive of its own independent interests and more active in world affairs. The conservative elements will almost certainly continue to control Japanese governments for the foreseeable future and Ikeda will probably retain the Premiership for the next year, at least. Japan's economy will probably continue to expand at a rapid rate although it will remain sensitive to adverse actions abroad beyond the control of the Japanese. (Paras. 15-22)

2. Ikeda will almost certainly have his hands full coping with dissension within his party and with an irresponsible and increasingly aggressive opposition in the Diet. Consequently, he will probably exercise extreme caution in dealing with sensitive domestic or foreign policy issues and will emphasize domestic economic measures of popular appeal to the Japanese. He will seek to avoid accusations of highhandedness or subservience to foreign pressures. (Para. 16)

3. Pacifist and neutralist sentiment, born of Japan's [REDACTED] fear of involvement in another war, will almost certainly continue to influence the government's execution of its pro-Western policies. In addition, there will probably be strong domestic pressures for the regularization of Japanese relations with Communist China. However, if the US maintains its opposition to recognition of Communist China, the Ikeda government probably will not take any serious steps in this direction. (Paras. 23-27)

4. The Left will seize any opportunity to agitate the public and to maintain pressure upon the Japanese Government to obstruct effective implementation of the US-Japan security arrangements. In most circumstances, the Ikeda government will probably take fairly vigorous steps to oppose leftist efforts to obstruct operation of the US bases. [REDACTED]

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EO 12958 3.4(b)(1)-25Yrs
 EO 12958 3.4(b)(6)-25Yrs
 (S)

[REDACTED]

In addition, the utility of the bases would almost certainly be impaired by leftist mass demonstrations and labor boycotts, and possibly by sabotage.⁴ (Para. 28)

⁴ The Director of Intelligence and Research, Department of State, the Assistant Chief of Staff, Intelligence, USAF, the Director for Intelligence, Joint Staff, and the Assistant to the Secretary of Defense, Special Operations, would substitute the following text for the last four sentences of this paragraph:

[REDACTED]

[REDACTED]

barring an unexpected change in Japan's leadership, we believe that the Japanese Government would not stand in the way of US use of Japanese bases for logistical purposes in support of security operations elsewhere in the Far East during the next year or so, although it would expect to be informed in advance of our intentions.

DISCUSSION

I. INTRODUCTION

5. Japan is passing through profound political and social changes. Although the rulers of Japan had successfully imposed selected Western institutions upon a traditionalist society gradually over a period of nearly a century, the impact of defeat and US occupation shook Japanese society to its foundations. In particular, the psychological atmosphere is still overcast with the memories generated by the only two nuclear weapons ever used in war. Nevertheless, fifteen years after the end of World War II, Japan has emerged as an independent and economically significant Asian and world power. Sharply contending alternatives are being presented to the Japanese people by a radical Left which favors neutralism and closer association with the Sino-Soviet Bloc, and a conservative Right that favors association with the US. Political life in 1960 was dominated by issues relating to Japan's alignment with the US and the West.

II. THE JAPANESE SITUATION

6. There are many elements of stability and strength in Japan. It is economically vigorous and prosperous. Its gross national prod-

uct (GNP) has increased at an average annual rate of 9 percent over the past decade; GNP rose 18 percent in 1959 and another 11 percent in 1960. Its standard of living is by far the highest in Asia, and per capita GNP in 1959 was 75 percent above the prewar level. The majority of the electorate remains basically conservative; the November Diet elections returned the conservatives to power by 60 percent of the popular vote. Under the ruling Liberal Democratic Party, the Japanese Government continues to look to the US for military and economic security and has publicly rejected neutralism. Despite considerable public reluctance, the government is continuing slowly to improve Japan's military establishment.

7. The events of the past year, however, are reminders of modern Japan's social, political, and psychological dislocations, which were accentuated by World War II and subsequent events. With military defeat, the entire panoply of state authority and order collapsed, hastened on its way by the conscious efforts of the occupation to introduce new, democratic forms. Fifteen years after World War

EO 12958 3.4(b)(1)-25Yrs
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II Japan is still groping for a national consensus regarding the political and social patterns to replace those swept away in 1945. Although Japanese ingenuity and industry have brought about a remarkable economic recovery, political and social reconstruction has been slow and uncertain. Japan's concept of democracy tolerates an excessive degree of political irresponsibility among the conservatives, the Left, the press, and the intelligentsia.

8. Japanese attitudes towards foreign affairs are ambivalent. A pervading desire for non-involvement, for escape from international political obligation, exists side by side with a desire, on the part of the great majority of the Japanese, for US assurance of Japan's security and economic opportunity. The Japanese people, in the main, admire the US and dislike and mistrust the Bloc. However, there is a latent neutralist sentiment in Japan shared by most elements of the population and particularly strong among the generation that has come of age since the war. The widespread Japanese desire for noninvolvement springs from the experience of war and defeat and an effort to find a new position in a divided world. It springs also from a deep distrust of militarism and authoritarian government, a reluctance to assume the economic burden of rearmament, a horror of nuclear weapons and another major war, and a desire to avoid the unpleasant realities of the cold war while pursuing a better life for the Japanese people.

9. In this setting, there is an increasing tendency for polarization of Japanese political forces between the conservatives and the Left. The Left is largely urban, organized, and militant, and draws strong support from the politically active labor movement. Though it has deep schisms, the Left is often able to work cohesively in its opposition role and wields a disproportionate influence at the national level. On the other hand, conservative strength is based in those elements of the population, particularly in rural areas, which tend to be politically passive and inarticulate. In consequence, the conservatives, although in the majority at the polls,

lack organized means of making their will felt in the national capital in times of political crisis. Moreover, the governing Liberal Democratic Party is a coalition of eight or nine factions, held together by a common policy outlook but divided by personal rivalries for power.

10. The conservatives and the Left are sharply divided on the issue of Japan's basic international orientation and on key domestic issues. The conservatives advocate the continuation of Japan's postwar policy of alignment with the West, the strengthening of Japanese defense potential, and the modification of occupation reforms. The Left espouses the goal of a neutral Japan and advocates abrogation of security ties with the US.

11. The Left feels little obligation to abide by decisions of the parliamentary majority and frequently resorts to extraparlimentary pressures. When such pressures take the form of mass demonstrations and violence, conservative governments, aware of public fear of a reversion to police state methods, have been hesitant to permit the police to exercise more than nominal restraints. On the whole, the stability of conservative governments tends to be precarious in times of political crisis, especially when the Left enjoys broad popular acquiescence in its position and the Prime Minister lacks the full support of his own party.

12. The leftist riots of May-June took place at a time when the underlying concerns described above were greatly intensified by certain immediate events: the U-2 incident, the breakdown of the Paris Summit Conference, the approach of President Eisenhower's visit, and, above all, Prime Minister Kishi's action in pushing ratification of the US-Japan Security Treaty through the Diet. Anti-Kishi demonstrations began as university students took to the streets to protest Kishi's treaty action and his leadership in general. Socialist and labor elements soon joined in and, spearheaded by Communist agitators, the riots took on a distinctly anti-US flavor. Although the demonstrations and riots could not nullify the ratification of the US-Japan Security Treaty, they did cause the collapse of

the Kishi government and damage US prestige, and thereby served the interests of the Bloc. Moreover, the riots demonstrated the potential power of the organized Left to bring pressure upon the Japanese Government to restrict or deny the US use of certain military bases in Japan in future crisis situations.²

13. The November Diet elections reflect both continuity and change in present Japanese politics.³ There has been no major change in the distribution of parliamentary power. The Liberal Democratic Party won 298 of 467 seats, retaining the support of a substantial majority of the Japanese electorate. Many traditional voting patterns continue: the conservatism of rural Japan; the tendency for local issues to have a great bearing on elections, especially outside the major cities; and the strong influence of personal relationships and loyalties on the Japanese voter.

14. The Democratic Socialist Party, which was formed in 1960 by a moderate faction of the Japan Socialist Party, dropped from 40 to 17 seats, while the Japan Socialist Party in-

² The Director of Intelligence and Research, Department of State, the Assistant Chief of Staff, Intelligence, USAF, and the Assistant to the Secretary of Defense, Special Operations, consider that this paragraph yields a misleading impression of the significance of the events under review. In their opinion, the demonstrations and riots reached the proportions they did because of a unique combination of international and domestic circumstances. The paragraph should state clearly that public tolerance or support of the demonstrations was attributable far more to antagonism against Kishi personally than to neutralist and antiretro sentiment. It should point out that the Communists failed in their effort to turn the demonstrations into a broad anti-American movement and that Communist-instigated violence at the end provoked an adverse public and press reaction against such extremism. Finally, it should point out that the power of the organized Left to bring pressure on the Japanese Government applies to the whole gamut of governmental policies (for example, in the 1958 Police Duties Bill fiasco), not just to the US use of military bases, but that the capability of the Left to mount operations of scope and effectiveness of May-June 1960 depends largely on the evolution of foreign and domestic circumstances exceptionally favorable to leftist objectives.

³ See table in Political Annex for results of Japanese lower house elections since 1952.

creased its strength from 122 to 145 seats. Although the Japan Communist Party received only 2.9 percent of the popular vote, it increased its representation in the Lower House from 1 to 3 seats and received 144,000 more votes than in 1958. The combined Socialist, Democratic Socialist, and Communist popular vote increased from 35.5 percent (1958 elections) to 39.3 percent. The Sohyo labor federation, closely allied with the Japan Socialist Party, has been greatly strengthened by the elections, while its rival, the moderate Zenro federation, which supported the Democratic Socialists, has been weakened. The more radical elements have increased their dominant position in the Japan Socialist Party, which has retained its position as the only significant opposition party. Furthermore, it appears that a substantial majority of young Japanese reaching voting age have cast their ballots for the Japan Socialist Party.

III. THE OUTLOOK

A. Internal Political Outlook⁴

15. The conservative elements will almost certainly continue to control Japanese governments for the foreseeable future and Ikeda will probably retain the Premiership for the next year, at least. By Japanese standards his government is a competent but not an outstanding one.

16. Ikeda will almost certainly have his hands full coping with dissension within his party and with an irresponsible and increasingly aggressive opposition in the Diet. His administration, at least during its first year, will probably endeavor to consolidate its position and to avoid undue exposure to the opposition's line of fire. Consequently, Ikeda will probably exercise extreme caution in dealing with sensitive domestic or foreign policy issues and will emphasize domestic economic measures of popular appeal to the Japanese. In so doing, he will seek to avoid accusations of highhandedness or subservience to foreign pressures.

⁴ See the Political Annex for details concerning the political parties.

17. Seeking to expand its popular base, the Japan Socialist Party will portray itself as the champion of Japan's independent interests and will sharpen its campaign to exploit problems in US-Japan relations and the widespread interest in closer relations with Communist China. It will be especially alert for political opportunities offered by even routine problems arising over the Ryukyus and in connection with US-Japan security arrangements. Because of its minority position in parliament, the Japan Socialist Party will almost certainly continue to resort to mass demonstrations and other extraparlimentary pressures in order to augment its influence on key issues. This tendency will be encouraged by the proved effectiveness of such tactics during 1960 and by the probable increasing dominance of radical elements, particularly the leadership of the Sohyo labor movement, within the party. The more moderate party leaders will seek to restrain this tendency, but, in a crisis situation, they are unlikely to be able to control extremists within the party or the course of mass demonstrations once they have been launched. Opposition attacks on the government will almost certainly focus upon a number of foreign policy issues, particularly the normalization of Japanese relations with mainland China, which we believe will become a major issue in Japan this year. The opposition's attacks upon the Ikeda government will be buttressed by the attraction of neutralism and a strong current of discontent with Japan's foreign policy among the intellectuals, college students, and white collar workers.

B. Defense Establishment⁵

18. Development of the Japanese military establishment has been hindered by postwar antimilitary sentiment, but its public acceptance has gradually increased. Despite constitutional restrictions and political opposition, measures for strengthening and modernizing the Self-Defense Forces will continue

during 1961. Although proposed defense legislation will probably remain controversial, completion of the currently approved reorganization will represent a significant gain in military effectiveness. The Self-Defense Forces are capable of maintaining internal security, but the government will remain most reluctant to employ military forces for this purpose. Over the period of this estimate, Japan will continue to depend almost entirely upon US deterrent strength for its defense.

C. Economic Outlook⁶

19. Barring adverse developments in international trade, the economy will probably continue for some time to expand at a rapid rate, propelled by high rates of increase in industrial production (22 percent in 1960) and investment (20 percent). Although the rate of population increase has dropped to .8 percent, the labor force is still growing at a faster rate and an industrial labor surplus will probably persist. Moreover, there is an increasing public demand for rising living standards. Any significant slowdown in the economy would have immediate political repercussions adverse to the Ikeda government and probably to the entire conservative position.

20. Because the Japanese economy is so dependent on foreign trade, the increase in GNP necessary to provide expanding employment and rising living standards will require considerably expanded markets and imports. Therefore Japan will remain extremely sensitive to foreign market conditions and the actions of foreign governments, especially the US, as about one-third of Japan's total trade is with the US. The US directives of November 1960 calling for a cutback in dollar expenditures abroad have had a considerable psychological impact in Japan. The implementation of these directives, the settlement of Japan's obligations for occupation-era support, and developments in US trade policy are likely to raise political issues in Japan which the conservatives would find embarrassing and the opposition could exploit.

⁵ The principal judgments respecting the Japanese Self-Defense Forces found in NIE 41-60, "Probable Developments in Japan," dated 9 February 1960, remain generally valid.

⁶ See the Economic Annex for details on Japan's economy.

21. The Japanese hope to increase their trade with the US, but their most immediate concern is to hold their present share of the US market. To strike a better balance in its foreign economic relations Japan will step up its efforts to improve its trade with other Free World areas, particularly Western Europe, and will seek US good offices to this end. The longstanding interest of many Japanese businessmen in increased trade with the Communist Bloc, and especially Communist China, will also persist and will be intensified if Free World countries should take actions adverse to Japan's trade interests.

D. International Orientation

22. Japan will almost certainly remain aligned with the US over the next year or so. In line with trends of the past few years, however, Japan will continue slowly to grow more assertive of its own independent interests and more active in world affairs. These developments will in large degree be the result of US efforts to assist Japan to become a strong and independent nation, and will hold promise of a more natural relationship between two great nations working independently toward mutually beneficial world goals. By and large, this will be the concept of US-Japanese relations held by Prime Minister Ikeda, most of the Liberal Democratic Party, and a substantial portion of conservative Japanese opinion.

23. Neutralist sentiment will almost certainly continue to influence Japanese politics during the next year or so. However, the degree to which it is translated into an active political force resulting either in increased support of the Left or modification of government policies will be determined by several factors: the course of Japan's international economic fortunes; Japanese assessments of developments in US world strength; the policies of the Bloc, and especially Communist China toward Japan; and the effects on Japan of major international developments. The US overall military position in the world no longer appears to many Japanese to be as secure and commanding as it did before the USSR's dramatic advances in weaponry and Commu-

nist China's rapid growth in strength on the nearby mainland of Asia. The Japanese will continue to be sensitive to any developments which they might construe as presaging a change in basic power relationships in the Far East or as invalidating existing Japanese foreign policy positions.

24. Unless, as is unlikely, Bloc policies become much tougher than they already are toward Japan, the combination of pervasive neutralist sentiments, political pressures exerted by the Japanese Left, and the growing independent spirit will almost certainly cause the Japanese to become more active in seeking ways of improving relations with the USSR and Communist China. Trade with the USSR will probably continue to increase. However, there is strong suspicion and hostility toward Russia in Japan, and the issues of Soviet occupation of the South Kuriles and restrictions on Japanese fishing are formidable, although not insurmountable, obstacles to a closer rapprochement, let alone a formal peace treaty. Concessions on these matters would not be very costly to the USSR, and the Soviets might make them at any time that they believed such a move could affect Japan's alignment with the US. During the next year or so, however, we believe that Japan's posture toward the USSR is not likely to be greatly altered.

25. In contrast to their attitudes toward Russia, the Japanese have a sense of historic and cultural affinity with China. In addition, many Japanese businessmen continue to regard the China mainland market as a natural and profitable outlet for Japanese goods, despite evidence to the contrary. For these reasons, and because of political pressures from the Japan Socialist Party and Sohyo, there will be a growing tendency in Japan, even among the conservatives, to seek ways and means of regularizing trade and diplomatic relations with the China mainland. Ikeda will almost certainly oppose any rapid movement toward establishing full diplomatic relations with Peiping, but at the same time he will almost certainly sanction some increase in private trade, cultural relations, and low-level technical agreements. If Peiping

were to modify its present strict conditions and hard-nosed attitudes, domestic pressures would probably force Ikeda to move rapidly to expand trade and other relations.

26. The Japanese will be especially sensitive to any indications of change in US policies toward Communist China or in the international standing of the Republic of China. Any relaxation in the US attitude toward Peiping would stimulate existing pressures for regularizing Sino-Japanese relations. Even if the US position remains unchanged, there will be strong Japanese sentiment for dropping support for the US-sponsored moratorium when the issue of Chinese representation comes up again in the UN this fall. However, in view of the important Japanese economic and security interests in Taiwan, the Japanese Government would probably prefer to see some kind of "two Chinas" solution to the questions of UN representation and the maintenance of diplomatic relations, although it recognizes that such a solution is equally abhorrent to Peiping and Taipei.

27. If, over the next year, the US maintains its opposition to recognition of Communist China, the Ikeda government probably will not take any serious steps in this direction. If Communist China were admitted to the UN without provision for Taiwan representation, Japan would probably continue to refuse to extend diplomatic recognition. However, if in the unlikely event that some accommodation respecting Taiwan were arrived at in admitting Communist China, the Japanese Government would probably soon extend recognition to Peiping whatever the US attitude.

28. The Left will seize any opportunity to agitate the public and to maintain pressure upon the Japanese Government to obstruct effective implementation of the US-Japan security arrangements. In most circumstances, the Ikeda government will probably take fairly

vigorous steps to oppose leftist efforts to obstruct operation of the US bases.

In addition, the utility of the bases would almost certainly be impaired by leftist mass demonstrations and labor boycotts, and possibly by sabotage.¹

¹ The Director of Intelligence and Research, Department of State, the Assistant Chief of Staff, Intelligence, USAF, the Director for Intelligence, Joint Staff, and the Assistant to the Secretary of Defense, Special Operations, would substitute the following text for the last four sentences of this paragraph:

barring an unexpected change in Japan's leadership, we believe that the Japanese Government would not stand in the way of US use of Japanese bases for logistical purposes in support of security operations elsewhere in the Far East during the next year or so, although it would expect to be informed in advance of our intentions.

ANNEX A

POLITICAL

1. *The Ikeda Cabinet.* In selecting his new cabinet following the November 1960 elections, Ikeda put the emphasis upon continuity and stability, avoiding for the time being any factional fight that a sweeping cabinet reshuffle might cause. Nine of the Ministers are hold-overs from Ikeda's pre-election cabinet, including those in such key posts as foreign affairs, finance, and labor. Furthermore, the new cabinet, while including representation from all major factions of the Liberal Democratic Party, continues to be based primarily upon the three predominant factions of Ikeda, ex-Premier Kishi, and Kishi's brother, Eisaku Sato. These three factions hold 12 of the 19 ministries, including most of the key cabinet positions. Ikeda is generally expected to undertake a cabinet reshuffle after the end of the regular Diet session, probably in July, at which time he will probably attempt to form a stronger cabinet with broadened party responsibility by including factional leaders themselves.

2. *Factionalism in the Liberal Democratic Party.* The November election caused little shift in the relative distribution of factional strength within the party. Although factional strengths are difficult to ascertain with certainty, they appear to line up as follows. The present Ikeda-Kishi-Sato coalition has about 150 seats in the Lower House. Ikeda has 53 followers while Kishi and Sato each have 48. After a striking decline in prestige last summer, Kishi has regrouped his faction; Ikeda has made slight gains; and Sato has gained considerably. Ichiro Kono, a bitter opponent of Ikeda, remains with about 35 followers. Takeo Miki has retained his immediate following of about 30 and is trying to consolidate his leadership of several minor factions having a common interest in opposing Ikeda. Altogether the anti-Ikeda forces in the Liberal Democratic Party have a combined strength of about 115 members. Former Foreign Minister Fujiyama, who is favorably disposed toward Ikeda, heads the remain-

ing faction and has about 30 followers. At present, the major contenders to succeed Ikeda as Prime Minister are Takeo Miki and Eisaku Sato.

3. Sporadic factional in-fighting will continue to mark the activities of the Liberal Democratic Party. Certain personal antagonisms, such as between Kono and Ikeda, account for much of the factionalism. More importantly, the conservative leadership apparently does not regard the Socialist and Communist gains in the elections as serious enough to require a closing of the ranks. As they see it, the Liberal Democratic Party emerged from the elections with added strength. The party won 296 seats in comparison with 287 in the May 1958 elections. When four persons elected as independents chose to join it, the Liberal Democratic Party obtained the largest Diet representation of any postoccupation party.

4. *The Japan Socialist Party.* With the election, the Socialists advanced from 122 seats to 145. The elections strengthened the majority position of the party's left wing. About 50 of the party's members of the Lower House are Sohyo labor leaders. By contrast, moderate elements led by Jotaro Kawakami remained in the distinct minority with only about 30 seats. The Socialists hope to stimulate the disintegration of the centrist Democratic Socialist Party and to attract its elements back into the Japan Socialist Party. This objective lies behind the agreement among Socialist leaders to elect aging, ineffectual right-wing leader Kawakami to the post of Party Chairman. Buoyed up by their success at the polls and the decline in the competing Democratic Socialist Party, the Socialists have recovered from their low ebb in 1959 and view the prospect of further gains against the Liberal Democratic Party with some confidence. An important factor in Socialist optimism is the demonstrated success of the party in attracting the support of the students and young urban groups, who are believed to have voted

overwhelmingly for the Japan Socialist Party in November.

5. *The Democratic Socialist Party.* When this party was formed in early 1960 from dissident rightwing members of the Japan Socialist Party, under the leadership of Suehiro Nishio, it initially included 54 Diet members and had the full support of Zenro, Japan's second largest trade union organization. The party went into its first test at the polls in November, strenuously campaigning to pin a pro-Communist and anti-US label on the Japan Socialist Party. It sought to maintain a central position between the two major parties by advocating an independent foreign policy—neither pro-Communist nor unduly reliant on the US—which included recognition of Communist China and the gradual modification of existing US-Japan security arrangements. It stressed adherence to parliamentary practices and a moderate trade unionism. Many Japanese believed this program to have considerable appeal for the Japanese voter and the failure of the Democratic Socialist Party at the polls came as a surprise. The party elected only 17 members. The major effect of the party's defeat is to remove for the time being even the prospect of a moderate and responsible opposition party to which governmental power could be transferred without radical changes in Japan's political and economic structure and international orientation.

6. *The Japan Communist Party.* In the November elections, the Communists increased their strength in the Lower House from one to three seats and received 2.9 percent (1,158,000) of the popular vote, an increase of 14 percent over 1958 and the highest vote since 1949 when the Communists received 9.8 percent (2,985,000) of the vote. Party membership is now believed to be approaching 90,000, a sharp increase of about 20,000 after several years of near stagnation. More significant however is the party's emergence over the past year from isolation on the Japanese political scene. Through its united front tactics, the Japan Communist Party has become an acceptable partner in joint action with many leftwing groups. The capability of the Communists for covert action has prob-

ably increased and they will probably continue, with some success, to attempt to penetrate the Japan Socialist Party and Sohyo in order to bolster the influence of their leftwing elements.

7. *The Rightist Element.* Various events, most notably the boldly public assassination of Japan Socialist Party Chairman Inejiro Asanuma in the midst of the election campaign, have served to show that rightist elements have recently become more inclined toward direct and violent action in Japanese politics than at any time since the end of World War II. Their ability to influence political developments, except through isolated violence, is very small. The rightists have limited financial support and no backing from Japanese military elements. In the face of the highly organized labor unions and socialist parties, the rightist groups are fragmented and distrusted by the general public.

8. *Student and Teachers Groups.* Most Japanese university students identify themselves with the political Left and support the Japan Socialist Party. This results in part from the postwar rebellion by the young against the customs of their conservative elders, and in part from the pacifist idealism and new democratic freedoms promoted by the postwar constitution. The main student organization is Zengakuren—the All-Japan Federation of Student Self-Government Associations—which represents about half of Japan's 600,000 university students. The leadership of Zengakuren has been largely captured by the Communists, who are, however, split between competing factions, some of them even more radical than their mentors in the Japan Communist Party prefer. The leading teacher's union—Nikkyoso—is leftist in orientation and heavily infiltrated by Communists. Most secondary school teachers and a great many university teachers are pacifist, Marxist, and neutralist. Most university students seem to lose much of their radicalism after they graduate and begin their careers, but a considerable number of them are unable to find suitable employment and join the swelling ranks of frustrated, embittered, unemployed intellectuals.

RESULTS OF JAPANESE LOWER HOUSE ELECTIONS SINCE 1952

Election year	1952	1953	1955	1958	1960
Party					
Conservatives (LDP)					
Popular Vote	23,367,971 *	22,717,348 *	23,377,432 *	22,976,830	22,740,265
Popular Vote (percent)	67.2	65.7	63.2	57.8	57.6
Diet Seats	325	310	297	287	296 *
Socialists (JSP and DSP)					
Popular Vote	7,763,061 *	9,553,321 *	11,193,154 *	13,093,984	14,351,284 *
Popular Vote (percent)	21.9	27.5	30.2	32.9	38.4
Diet Seats	115	143	180	166	162
Communist (JCP)					
Popular Vote	896,785	655,970	774,158	1,012,036	1,158,723
Popular Vote (percent)	2.6	1.9	2.0	2.6	2.9
Diet Seats	0	1	2	1	3
Independents and Minor Parties					
Popular Vote	3,304,208	1,675,786	1,661,685	2,688,786	1,260,849
Popular Vote (percent)	8.3	4.9	4.0	8.7	3.2
Diet Seats	26	12	8	13	6

* Includes Liberal Party and Progressive Party.

* Includes Liberal Party, Japan Liberal Party, and Progressive Party.

* Includes Liberal Party and Democratic Party.

* Includes Right Socialist Party, Left Socialist Party, and Labor Farmer Party.

* Includes Japan Socialist Party and Democratic Socialist Party. Latter party, formed in early 1960 by former Right Socialists, polled 3,464,147 votes or 8.8 percent of the popular vote but won only 17 Diet seats.

* Since the elections in November the LDP has increased its Diet strength to 301 seats. Four of the five additional seats came from the accession of Independents to LDP ranks; one was gained because the postelection death of a Socialist candidate gave the seat to an LDP runner up.

ANNEX B

ECONOMIC

1. A broken and defeated country only fifteen years ago, Japan today is more prosperous than it has ever been before and the economy is expanding at a high rate. Since 1955, the rate of increase in Japan's gross national product (GNP) has only once fallen below 9 percent. In real terms, GNP in 1959 was 17 percent over 1958 and is expected to have increased by 11 percent in 1960. This rapid economic growth was caused partly by favorable conditions in the international trading community. But to a large extent, it has resulted from the energy and ability of the Japanese people themselves. Through their efficiency, labor, and investment, abetted by US investment and aid, they have returned Japan to its position as one of the Free World's four major industrial complexes. Japan now produces two-thirds of the cement, most of the steel and electric power, and virtually all the finished capital goods made in non-Communist Asia. In addition Japan leads the world in the production of steel ships and rayon textiles, and in the import of iron ore and raw cotton.

2. The fact remains, however, that the Japanese economy rests on a precarious foundation: it must import virtually all the raw materials its industry consumes, and it must export enough to pay for its imports. Moreover, a continued substantial increase in national production is required if Japan is to maintain high employment and the steady rise in living standards which the Japanese people have come to expect. Prime Minister Ikeda has called for doubling the national income in the next ten years, bringing per capita income to present Western European levels. Ikeda's program would imply an average annual increase of about 7 percent in GNP, a realizable

goal given no abrupt adverse changes in economic conditions abroad.

3. As of October 1960, Japan's population was about 93.4 million, fifth largest in the world. The population is expected to exceed 100 million by 1970. Within the growing labor force, the percentage of industrial workers is increasing due to the steady migration of farm workers to urban areas. Thus, despite the rapid growth of the economy, an industrial labor surplus persists.

4. Because the economy depends so heavily on foreign trade, an increase in GNP in the degree projected by Ikeda will require greater imports and expanded markets abroad. At present, Japan's trade is predominantly with the Free World, particularly North America and Asia. The US is Japan's best customer, taking almost one-third of its exports estimated at \$1 billion in 1960. In turn, the US is expected to supply 35 percent of Japan's imports valued at \$1.5 billion in 1960 (making Japan third after Canada and the UK as a customer for US exports). Trade with the Sino-Soviet Bloc is very slight, although the volume of imports from the USSR has been increasing at a substantial rate over the past few years.

5. Special dollar earnings, derived from US offshore procurement and other military spending in Japan, have been an important part of Japan's exports to the US. These earnings have averaged over \$530 million a year for the last five years and, since 1952, have made the difference between deficit and surplus in Japan's balance of payments. In 1960, special earnings probably equalled Japan's estimated \$600 million increase in foreign exchange reserves.

Table 1. SELECTED INDEX OF JAPAN'S ECONOMIC GROWTH
(Current Prices)

(Calendar years)	1952	1953	1954	1955	1956	1957	1958	1959
Gross national product	100	117	125	135	153	170	174	199
Gross national product per capita	100	115	122	133	145	160	159	183
Industrial production	100	122	132	142	174	206	207	256
Exports (f.o.b.)	100	100	128	158	196	223	225	272
Imports (c.i.f.)	100	119	118	122	160	211	150	177
Percentage increase over previous year of:								
GNP		16	8	10	10	11	11	17
Industrial activity *		20	8	8	23	16	1	24
Industrial production		22	8	8	22	18	0	24
Exports		0	28	23	24	14	1	20
Imports		19	0	3	31	32	-29	19
Personal consumption as a percent of GNP	59.7	61.5	63.3	61.2	60.0	58.3	61.2	56.5
Gross private investment as a percent of GNP	19.4	19.5	16.9	17.0	21.1	27.2	16.2	24.0

* Includes public utilities.

Source: Japanese Government.

Table 2. BALANCE OF PAYMENTS, 1955-1959 AND JANUARY-JUNE 1960
(Calendar years; values in millions of US dollars)

	1955	1956	1957	1958	1959	January-June 1960
Exports (f.o.b.)	2,006	2,482	2,854	2,871	3,413	1,632
Imports (f.o.b.)	-2,061	-2,613	-3,258	-2,501	-3,052	-1,878
Trade balance	-55	-131	-402	369	361	-46
Transportation and insurance (net)	-157	-316	-519	-176	-194	-150
Government net *	510	505	466	403	385	175
Other (net)	-94	-117	-135	-137	-148	-93
Balance goods and services	205	-59	-590	460	384	-114
Capital transactions						
Nongovernment	31	33	35	39	47	25
Government (reparations, short-term borrowing, etc.)	-9	-8	-65	-234	-70	-26
Balance	22	25	-30	-195	-23	-1
Net total all current transactions	227	-34	-620	264	361	-115

Figures may not add to totals because of rounding.

* Mainly special dollar receipts.

Source: Bank of Japan.

**Table 3. FOREIGN TRADE BY GEOGRAPHIC AREAS, CALENDAR YEARS
1936, 1955-1959, AND JANUARY-JUNE 1960**

	1936	1955	1956	1957	1958	1959	January- June 1960
Exports (billions of US dollars)	0.9	2.0	2.5	2.9	2.9	3.5	1.8
Imports (billions of US dollars)	1.0	2.5	3.2	4.3	3.0	3.6	2.2
Exports (percent of total):							
Asia	64	42	41	40	37	34	35
Europe	8	10	10	12	11	11	12
North and Central America	18	27	26	26	29	36	35
(United States)	(16)	(22)	(22)	(21)	(24)	(30)	(29)
South America	2	7	5	3	4	4	5
Africa	5	10	16	17	14	12	9
Australia and Oceania	3	4	2	2	3	3	4
Imports (percent of total):							
Asia	53	37	33	29	32	32	32
Europe	9	7	7	9	9	10	10
North and Central America	26	41	44	46	45	41	42
(United States)	(25)	(31)	(33)	(36)	(35)	(31)	(35)
South America	3	4	4	4	3	3	3
Africa	3	3	3	2	3	4	4
Australia and Oceania	6	7	9	10	9	10	9

Includes trade with Sino-Soviet Bloc.

Figures may not add to totals because of rounding.

Source: Japanese Government.

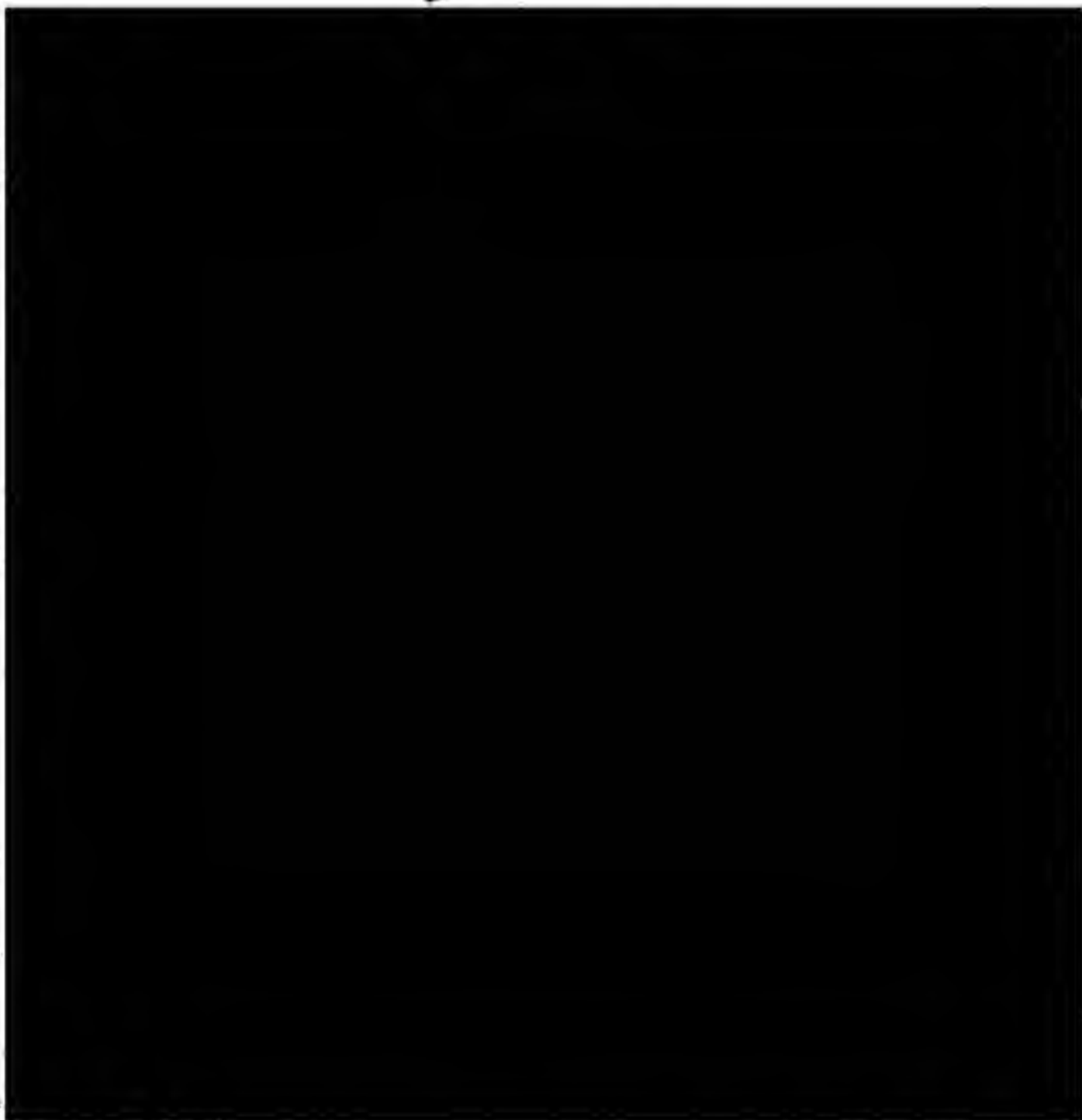
**Table 4. JAPAN'S TRADE WITH THE SINO-SOVIET BLOC, CALENDAR YEARS
1954-1959 AND JANUARY-JUNE 1960**
(In millions of US dollars)

	1954	1955	1956	1957	1958	1959	January- June 1960
Exports (f.o.b.):							
Communist China	19.1	28.5	67.3	60.5	50.8	3.6	1.6
USSR	Insig	2.1	0.8	9.3	18.1	23.0	16.2
Other	4.9	8.8	5.2	6.8	6.3	20.8	8.0
Total	24.0	39.4	73.3	76.6	75.0	47.4	25.8
Percent of Japan's World Total	1.5	2.0	2.9	2.7	2.6	1.4	1.4
Imports (c.i.f.):							
Communist China	40.8	80.8	83.7	80.5	54.4	18.8	11.8
USSR	2.3	3.1	2.9	12.3	22.2	39.4	33.5
Other	5.3	5.2	15.9	17.6	9.8	16.2	11.6
Total	48.4	89.1	102.5	110.4	86.2	74.4	56.9
Percent of Japan's World Total	2.6	3.6	3.2	2.6	2.8	2.1	2.5

Source: Japanese Government.

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March 1961

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Japan: STATISTICAL SUMMARY^{1/}

	1959	1960	1961	1962
<u>Exchange Rate (yen per \$)</u>				
Official	360	360	360	360(Aug)
<u>Gold & Foreign Exch. Reserves</u>	1,322	1,824	1,485	1,635(July)
		(millions of \$)		
<u>Balance of Payments(trans.basis)</u>				Jan-June
				1961 1962
Exports	3,280	3,874	3,992	1,875 2,210
Imports	3,007	3,727	4,924	2,396 2,369
Balance	273	147	-932	-521 -159
Invisibles	79 ^{3/}	-66	-185	-98 -123
(Special \$ Receipts) ^{4/}	(471)	(542)	(445)	(241) (180)
Current Account	352	81	-1,117	-619 -282
Transfer Payments	3/	30	32	10 23
Capital	109	411	773	691 468
Balance	461	522	-312	82 209
Errors & Omissions	-	-20	-27	6 -73
<u>Money Supply</u>		(billions of yen)		
Currency	923	1,097	1,319	1,209(Mar)
Deposits	2,788	3,323	3,939	3,701 "
Total	3,711	4,420	5,258	4,910 "
<u>Government Finance</u>				Jan-May
Revenues	1,871	2,415	3,057	1,381
Expenditures	1,932	2,361	2,997	1,143
Balance	-61	54	60	238
<u>Claims</u>				
On Public Sector	1,224	1,326	1,275	1,421(Mar)
On Private Sector	10,287	12,868	16,377	16,845 "
<u>G.N.P.(in real terms)</u>	33.3	38.7	46.4(annual est.)	
<u>Discount Rate (%)</u>	7.30	6.94	7.30	7.30(Aug)
<u>Cost of Living(1958=100)^{2/}</u>	101	105	111	120(July)
<u>Industrial Production(1955=100)^{2/}</u> (seasonally adjusted)	202	244	294	301(May)

^{1/}Unless otherwise indicated data are for end of period.

^{2/}Average for period.

^{3/}Transfer payments are included in invisibles for 1959.

^{4/}Includes AID-financed exports.

Men in the News

Kichiro Sato

Chairman of Special Research Council on Administrative Reform

"So long as we use the same old approach as has been adopted by similar committees in the past, there will be no improvement in the nation's administrative setup," is the first remark of Kichiro Sato who has just been nominated chairman of the Special Research Council on Administrative Reform.

So, he thinks that his committee must be as authoritative and competent as the Hoover Commission of the United States.

Shujiro Kawashima, director of the Administrative Management Agency, is said to have been thoroughly charmed by Sato who shows himself a rationalist to the core.

Before Kawashima formed this impression, he had not met Sato more than a few times with the mission to select members for the new council.

After graduating from Tokyo University as an English law major in 1917, Sato joined the Mitsui Bank, Ltd. and worked for 28 years overseas before assuming the presidency of the Teikoku Bank which was vacated by Junichiro Fendai under the postwar purge directive.

After the bank was split in to the Daiichi Bank and the Mitsui Bank in 1931, Sato remained president of the Mitsui Bank. He then became chairman of the board of directors of the same bank in December 1938 and ever since has been wielding the scepter over the whole Mitsui financial and industrial combine.

As such, he not only represents his bank but also is recognized publicly as one of Japan's most elderly bankers on the active list.

One proof of this public recognition is found in the fact that Sato's name was mentioned as a possible candidate for the post of Finance Minister for former Prime Minister Nobun-ke Kishi's Cabinet.

On the council in which he holds the chair, there are some ready critics of a different color and background rarely found in any similar Government advisory body, such as Kaoru Ohta, chairman of the General Council of Japan Trade Unions (Sohyo), former prosecutor general Tadaaki Hanai and Yuuji Takahashi, president of the Japan Newspaper Publishers and Editors Association.

And Sato readily admits that all these persons have their own views and ideas of what the projected administrative reform should be and that no consensus is readily forthcoming.

Nevertheless, he appears to be burning with the ambition to accomplish this formidable task.

A native of Yokohama, Sato, 67, plays golf and is fond of the game of go.

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12 April 1963

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SPECIAL REPORT

OFFICE OF CURRENT INTELLIGENCE

PROSPECTS FOR THE LEFT IN JAPAN

APPROVED FOR RELEASE
DATE: NOV 2000

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12 April 1963

PROSPECTS FOR THE LEFT IN JAPAN

Japanese leftists, represented mainly by the Socialist Party (JSP), have showed steady gains since World War II. Strongly imbued with Marxism and competing with a small, energetic Communist party, the JSP has advocated many international policies similar to those of the Communists. Japan's economic boom and increased international contacts have recently tended to moderate the party's line, however. Continuation of the leftward trend of Japanese voting would give the left-wing parties as a whole a majority within six or seven years. While the deep divisions among them might make it difficult to translate a bare majority into control of a government, their greatly augmented strength would jeopardize Japan's current role in the free world. The left has been united in denouncing the US-Japanese Security Treaty and espousing a neutralism that is in most cases benevolent toward the Sino-Soviet bloc.

The Drift to the Left

The tendency of the Japanese to vote left has remained unaffected by the changes that have taken place in Japan and in its place in the world. This leftward drift, which is relatively unaffected by current political issues or shifts in public opinion, reflects basic sociological and psychological phenomena.

A primary factor in this gradual development is the continuing shift of population from rural areas to urban centers. Agricultural workers traditionally support the conservatives, and industrial and commercial employees through their unions have staunchly supported the left. Agricultural and forestry workers decreased by more than 400,000

in 1962 (when they totaled slightly over 13 million) and are expected to decrease by more than 5 million by 1970.

In contrast, other workers gained by nearly one million in 1962 to total 32.6 million. Union membership is the dominant factor accounting for most of the urban leftist vote. The new workers join a labor union and, despite their conservative rural background, seem to fall readily into the political patterns of their adopted group.

Most new voters initially vote for the left. Any tendency to switch allegiance to the conservatives as they age is more than offset by the greater number of new voters in each election--a development that

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will be more pronounced as the high birth rate of the early postwar period is felt in the late 1960s.

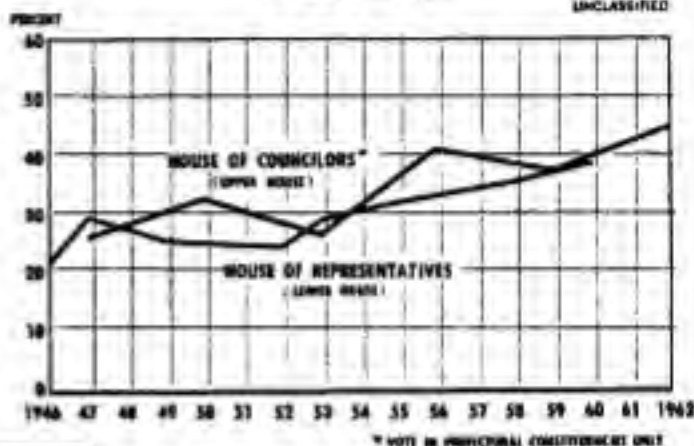
Youthful radicalism has been especially persistent in Japan, perhaps as a result of the discrediting of the old order by Japan's defeat. It is also a product of the long-standing maladjustment of the intellectual in Japanese society. After Japan's defeat, underpaid teachers, writers, and journalists, expounding Marxist doctrine, quickly gained a dominant influence among students and jobless graduates. Leftist influence remains strong among these groups.

Marxist Ideology

Japan's defeat and ensuing democratization gave the long-suppressed Marxist-oriented socialists, labor leaders, and Communists the opportunity to emerge as liberated martyrs who had consistently opposed the old order. They claimed the right to lead Japan on a prescribed course conceived in Marxist terms. Marxism became, and has generally remained, the prevailing philosophy, not only of the small Communist minority, but of the great majority of leftists who are supporters of the JSP. The only leftist party which has disavowed Marxism is the small Democratic Socialist Party (DSP), which was formed in January 1960 by secession of part of the JSP's right wing.

Marxism gives a revolutionary color to the programs

LEFTIST VOTE IN JAPANESE PARLIAMENTARY ELECTIONS
(IN PERCENT OF TOTAL VOTE)



and policies of the left and creates a deep chasm in Japanese politics, across which there is little communication. Ideological conflicts, moreover, have provided the theoretical framework for the factionalism that plagues the parties of the left.

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The Communist Party

The Communist Party (JCP) is the smallest of the left in parliamentary representation and influence, with three members in the lower house and four in the upper. In the series of local elections throughout Japan which will come to a peak in the latter part of April, the JCP is making an effort to increase its present one percent of local officeholders. As often in the past, however, it is supporting many candidates put up by the JSP.

Through penetration of popular movements and placing its supporters strategically in

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labor unions and government offices, the JCP wields significant indirect influence. Its troublemaking potential was best shown in the staging of large-scale leftist demonstrations and riots in 1952 and 1960.

The JCP suffers from its reputation [redacted] for subservience to foreign control, and has been hurt in trying to keep up with the fluctuations in the international Communist line. It now is trying to straddle the fence in the Sino-Soviet controversy. Its heart appears to be in Peking, but Moscow's financial assistance and stress on the popular "peaceful coexistence" theme compel the JSP to protest its neutrality.

The Socialist Party

The JSP holds the bulk of the leftist support. Between 1946 and 1958 it nearly doubled its percentage of popular vote in national elections, reaching almost one third of the total.

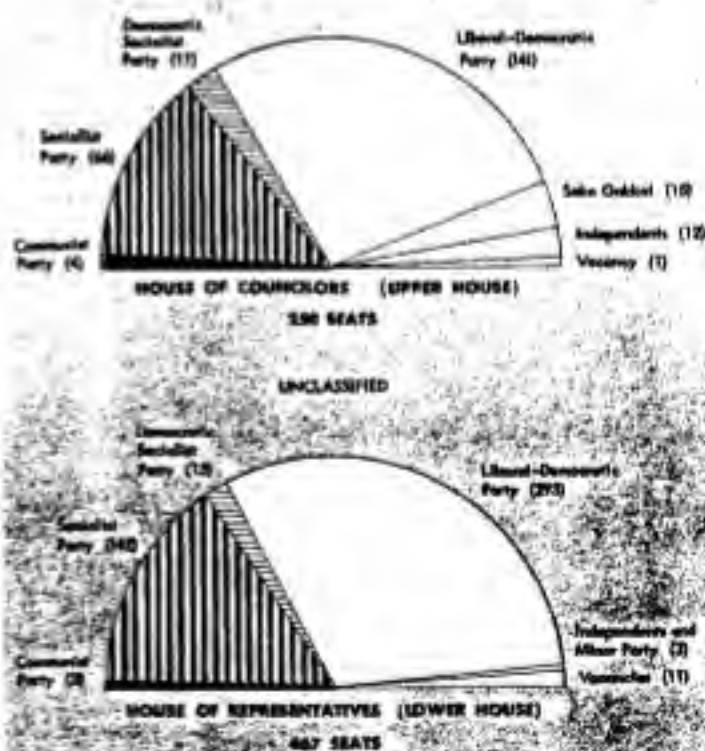
Cast continually in an opposing role and lacking any immediate prospect for gaining power, the party generally couches its pronouncements in doctrinaire Marxist terms. Its foreign policies are similar to the Communists', although it calls for "positive neutrality" and opposes the possession of nuclear weapons by any power, including the Soviet Union and Communist China. The JSP has remained largely isolated from the anti-communism and moderating currents which have affected the

socialists of Western Europe. Instead, it has occasionally looked to the Communists of Italy and Yugoslavia for contemporary inspiration.

The party relies heavily on the organizational and financial support of the four-million-member General Council of Trade Unions (Sohyo). Far the largest labor organization in Japan, Sohyo has long been controlled by Marxist militants and, until recently, was firmly wedded to a program of radical political action.

The JSP shies away from united-front action with the Communists, but contains a

PARTY STRENGTHS IN THE JAPANESE DIET



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strong left wing eager for close ties with them. Competition with the Communists for the Marxist intellectuals' vote and the influence of Communist renegades contribute to its extremism.

The existence of the middle-of-the-road Democratic Socialist Party has probably kept the JSP from straying further to the left. Moderate, non-Marxian Socialists have been kept in the JSP by timely compromises on immediate issues and by the attraction of office in the far larger organization.

Democratic Socialist Party

The DSP has remained a sickly splinter party, kept alive only by the funds of the million-odd-member Congress of Trade Unions (Zenro) and by the zeal of a few Western-oriented intellectuals.

It has been close to the socialists of Western Europe, and is patterned along the lines of the West German Social Democratic Party. Inaugurated to repudiate the pro-Communist proclivities of the JSP, it has failed in its aim of attracting a wide segment of the growing Japanese middle class.

The decline of its Diet representation from 40 to 17 (since reduced by deaths to 15) in the 1960 general election for the lower house was a blow from which it has not recovered. In the 1962 upper house election

its vote fell further and it lost four seats; it may not survive another election.

The Rightward Mood

The trend toward the left in voting has been lately accompanied by what the Japanese refer to as a "rightward mood" on the part of the socialists, e.g., a shift in emotional and intellectual attitudes and a resulting moderation.

In the mid-1950s the Hungarian uprising and Khrushchev's denunciations of Stalin raised the intellectuals' doubts about Communism. Subsequently Communist China's economic setbacks, the Sino-Soviet dispute, and the increased foreign contacts of the intellectuals have encouraged moderation. The most significant internal development which has brought about at least a temporary detour to the right by both the JSP and JCP was the widespread revulsion to the violence and excesses marking the struggle over ratification of the US-Japanese Security Treaty in 1960.

A more basic if slow-working force has been Japan's phenomenal economic growth over the past decade, which has benefited all levels of society. Increased foreign acceptance and growing pride in Japan's new place as a partner in the free world also are influences for moderation.

The present moderation could be nothing more than a passing mood. Nevertheless, considerable

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evidence suggests a deep and continuing trend. The JSP's trade union base, Sohyo, has gradually shifted to an emphasis on primarily economic rather than political issues, more like its American and West European counterparts. Younger and less doctrinaire leaders appear to be gaining rank-and-file support. The influx of conservative-minded rural workers into the unions may slowly be having some moderating influence.

JSP policy actions have been increasingly concentrated on immediate, concrete issues affecting the welfare of the masses. There is growing interest in a concept known as "structural reform," which calls for avoiding class war and revolution and introducing a "mass" party with a program of broader appeal to a wide public. The term is borrowed from Italy's Communist chief, Palmiro Togliatti, to make it palatable to at least some of the extreme left.

At the same time the JSP now is trying to distinguish its program clearly from that of the Communists. Last summer it broke openly with the Communist-controlled antinuclear-bomb organization and has moved recently, with Sohyo support, to reconstruct this popular movement free of Communist control.

Outlook

Either of these trends in Japanese political behavior--

the continued growth of the leftist vote and the recent rightward drift in left-wing attitudes--is subject to influences in the social, economic, or international milieu which could check, divert, or reverse it.

If Japan's domestic and international position continues relatively stable and prosperity spreads, the JSP is likely to become an increasingly formidable factor, as its share of the vote and of the seats in the Diet gradually grows. In the process, its stronger popular position might cause the governing Liberal Democratic Party to gain new vitality out of the necessities of competition.

The JSP's chances of gaining power in the foreseeable future would be enhanced by a continuation of the present trend toward modernization. This would enable it to reduce the deep divisions within the socialist camp and to compete for votes outside the ranks of urban workers and intellectuals.



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7 June 1963

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SPECIAL REPORT

OFFICE OF CURRENT INTELLIGENCE

JAPANESE LABOR'S TREND TOWARD MODERATION

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7 June 1963

JAPANESE LABOR'S TREND TOWARD MODERATION

During the past three years the federation representing the largest segment of Japanese organized workers, the General Council of Trade Unions (Sohyo), has gradually shifted toward a more moderate course than that followed in its first decade. While its leaders continue to use doctrinaire Marxist terminology and its fundamental policies have not been formally revised, Sohyo activities have been taking an increasingly pragmatic approach concentrated on economic problems. This trend shows signs of developing into a permanent transformation.

Background

Founded in 1950 with US encouragement to fight Communism in the Japanese labor movement, Sohyo was rapidly infiltrated by Communists who soon achieved a considerable measure of control. The secretary general during the early 1950s, pro-Communist Minoru Takano, argued that Communist China and the USSR were the great "forces for peace" with which Japan should work.

Sohyo tended to accept the Communist claim that the Japanese worker faced two enemies, monopoly capitalism and American imperialism. It leaned strongly toward the World Federation of Trade Unions, and worked closely with the Communist Party as well as with the Socialist parties on inflammatory popular issues. Sohyo regularly coupled the annual spring drive for wage increases with political demands, and frequently seemed preoccupied with political struggles unrelated to the workers' day-to-day problems.

Moderate elements won their first significant victory in 1955 when socialist Akira Iwai ousted Takano from the secretary generalship by a narrow electoral margin. Sohyo moderates nevertheless continued to go along with Communist tactics of pressing a militant political line, and during the next five years the pro-Communists exploited popular issues such as the Japanese-US security treaty in efforts to regain a dominant position. Over-all, however, economic considerations became increasingly influential--a shift which favored the moderates.

Two events in 1960 pushed the trend definitely against the militant pro-Communists. The excesses of the 1960 campaign against the security treaty touched off an adverse public reaction, and awakened labor's rank and file to the adverse consequences of extremist political activity. A prolonged and unsuccessful

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strike against modernization in the coal industry also cast doubt on the wisdom of fighting for fruitless causes and inclined the leadership toward actions that had some prospect of winning practical benefits. In November 1960 Sohyo's moderate leadership repudiated the previous policy of united action with the Communist Party.

Move to the Right

After 1960 the consolidation of moderate control was registered in elections in both constituent unions and in the parent body. In 1962, for example, a body of fence sitters in the National Railway Workers Union joined moderates to give them an unprecedented three-fourths majority at their convention. This year the moderates in the teachers' union--Sohyo's largest affiliate--received support of over 75 percent of the delegates at an extraordinary convention. Since 1961 the moderates have held 20 of the 25 seats on Sohyo's Central Executive Committee, and five of the six bureau chiefs elected in 1962 are of the same group.

Beginning in 1961 political issues were soft-pedaled--a shift formally acknowledged in Sohyo's annual policy document, "Basic Guidelines for Action." At the same time Sohyo sought to differentiate its approach from that of the Communists, and moved closer to the Japan Socialist Party (JSP). During this period it has followed the majority of its component unions



IWAI

in endorsing the JSP alone. Secretary General Iwai and many of the other leaders support the JSP's view that through "structural reform," rather than revolution, Japanese capitalist society can be adjusted more to the benefit of the workers.

The Coal Miners Union, which experienced the disastrous 1960 strike, has advanced the idea that workers can improve their lot within capitalism by pressing the government to pursue pro-labor policies. This now has ripened into a set of long-range "labor plans" to deal with the growing problem of modernization of industry, automation, and the resultant layoffs. In addition to the coal miners, the postal, telecommunications, and railway workers' unions have begun to draw up such plans. This approach is assuming greater significance for Japanese labor than the continued lip service paid to the traditional concept of class struggle.

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Foreign Policy

Parallel shifts have occurred in foreign policy positions. In discarding Takano's old theories, Sohyo has adopted chairman Ota's "third force" concept which calls for Japan to follow "positive neutrality" in the cold war and to support a bloc of nonaligned countries working for peace. The shock caused by the Soviet resumption of nuclear testing in September 1961 aided this shift, and the Sino-Soviet dispute has also aroused doubts that the Communist countries possess the perfect formula for peace and progress.

Sohyo's relations with Communist China, in particular, have cooled considerably. In 1961 a program of labor exchanges with Communist China was suspended, and a visit there by Iwai--first proposed for early 1962--has been repeatedly postponed. Ota has spoken out against linking China and Japan as common foes of US "imperialism." Top leaders frankly indicate their preference for the Kremlin's "peaceful coexistence" line over the bellicose threats from Peiping.

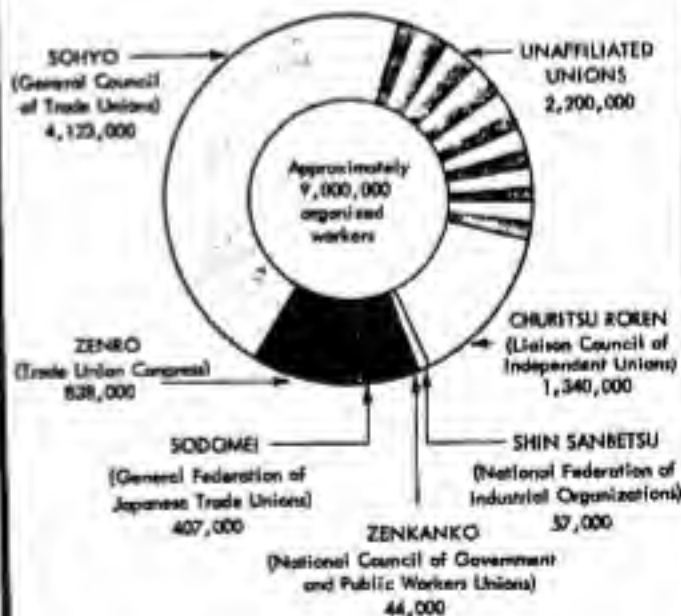
Although visits to the bloc are still popular, Sohyo has shown increasing interest in ties with the free world, and the number of delegations visiting the United States alone is almost as large as those going to the bloc. A few years ago they were four to one in favor of the bloc. While still theoretically committed to neutral-

ity between the WFTU and the anti-Communist International Confederation of Free Trade Unions, Sohyo has in practice moved closer to the latter. In 1962 Sohyo broke with the Communist-dominated Japan Council for the Prohibition of Atomic and Hydrogen Bombs (Gensuikyo) and is striving to reconstruct the antinuclear movement without allowing the Communists to run the show.

Rival Influences

One factor encouraging moderation has been the growth of distinct groups within Sohyo demanding less militant policies. Most recently, the formation of a movement labeled the

MEMBERSHIP OF JAPANESE LABOR ORGANIZATIONS



■ Members of DOMEI KAIGI (All-Japan Council of General Federation of Labor Unions)

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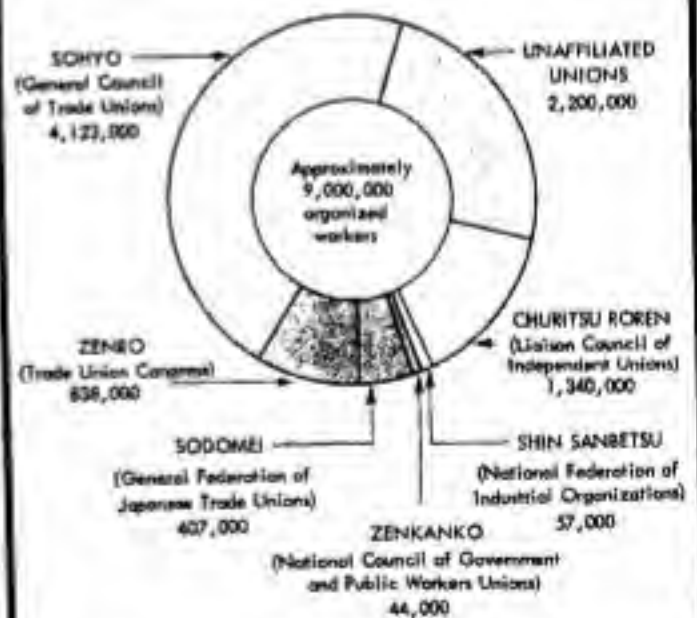
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National Democratization Liaison Council, made up of unions both inside and outside of Sohyo, has placed the federation's leadership under growing pressure to speed the trend to the right or risk significant defections.

Nevertheless, a pro-Communist minority remains active, and Sohyo's leadership still finds it expedient to cooperate with the Communist Party on an ad hoc basis. It avoids openly taking issue with the WFTU because of the continued desirability of appearing neutral and to avoid evoking protests from the extreme leftists.

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Assessment

Sohyo's weak rivals, particularly Zenro in the right-wing trade union grouping, Domei Kaigi, charge that the apparent drift to the right is nothing more than a tactic to undercut competition, and represents no real change. This argument is supported by Sohyo's ambiguity on many points, and the fact that its official dogma retains a basic substratum of uncompromising Marxism.

Nevertheless, there is much to indicate that what began as merely a defensive tactical shift to the right in 1960-61 is now being consolidated as a fundamental policy change along lines followed by labor movements in Western Europe. Barring a serious recession, widespread dismissals, or a grave international crisis that threatens to plunge Japan into war, Sohyo has taken so many different steps in the direction of moderation, and has found so much support for its rightward swing, that it would find it difficult to reverse its course. ~~(CONFIDENTIAL)~~

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*Scientific
Intelligence
Report*

Japanese Nuclear Energy Program

OSI - SR/64 - 55
18 November 1964



Office of Scientific Intelligence

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*Interpretations of intelligence information in this publication repre-
sent immediate views which are subject to modification in the light
of further information and analysis.*



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Scientific Intelligence Report

JAPANESE NUCLEAR ENERGY PROGRAM

OSI/SR/64-55
15 November 1964

CENTRAL INTELLIGENCE AGENCY
Office of Scientific Intelligence

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Project Officer

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Brief

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JAPANESE NUCLEAR ENERGY PROGRAM

Summary and Conclusions

The Japanese nuclear energy program is limited by law to peaceful purposes. Major applications to date have been the use of radioisotopes in research, medicine, and industry. Interest has been shown in nuclear marine propulsion and nuclear electric power. The first nuclear-propelled ship is being designed now. Current plans for power production are 1400 megawatts (electrical) by 1970. One station is now being built with British assistance.



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Discussion

Introduction

The Japanese nuclear energy program, which started in 1956, is based on a national policy for the development of the peaceful uses of nuclear energy. The Government has established an extensive nuclear research and development program; industry has made at least an equal effort in applied fields, and both are cooperating in programs for nuclear power and propulsion.

The shortage of funds and trained personnel and the lack of basic nuclear raw materials are being overcome by larger governmental appropriations and contributions from industry, establishment of training programs, and the importation of the necessary materials from other countries. Cooperation with other countries has particularly benefitted Japan in the construction of a number of research reactors and its first nuclear power reactor.

The major Governmental organizations are the Japan Atomic Energy Commission (JAEC) for planning; the Atomic Energy Board (AEB) for administration; and the Japan Atomic Energy Research Institute (JAERI), the Atomic Fuel Corporation (AFC), both at Tokai-mura, and the National Institute of Radiological Sciences (NIRS) at Chiba for research and development.

Research Reactors

Japan currently has 12 reactors in operation or under construction, 5 critical assemblies, 63 accelerators, over 70 installations for radiation research, and 17 facilities for fusion research. The major research site is JAERI, where most of the research reactors and a prototype power reactor have been constructed. All of the research reactors, except one, have been constructed with U.S. assistance and use enriched uranium fuel supplied by the United States. The one exception is the Japan Research Reactor-3 (JRR-3), a 10 megawatt (MW) natural-uranium-fueled, heavy-water-moderated reactor, which went critical on 13 September 1962. This reactor was constructed by the Japanese; however, Canada provided uranium for fuel through the IAEA and the United States supplied the heavy water -- both with safeguards. Construction of additional research

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reactors is contemplated, but all those presently planned will require enriched fuel, which Japan cannot provide.

Nuclear Materials

Extensive exploration for uranium has been conducted, but no substantial deposits of uranium have been discovered. Three areas have been found to contain low-grade deposits of uranium. The most promising area is Ningyo Pass, where mining has been started and construction of an ore concentration plant was begun in 1963-1964. Both AFC and industrial organizations have conducted considerable research to find an economic method to process the low-grade domestic ores. The AFC has a pilot plant for refining uranium and facilities for the production of uranium metal and fuel element fabrication.

While Japan has produced a limited amount of uranium, most of the fuel has been purchased from other countries. Over 25 tons of uranium concentrate have been purchased from Canada through the auspices of the IAEA. This concentrate has been processed into metal and fabricated into fuel elements by the Japanese. The natural uranium fuel for the first nuclear power station now under construction, will be supplied by the United Kingdom. About 750 tons of uranium metal are expected to be imported over the ten-year period at an estimated cost of \$27.5 million. The United States has supplied about 24 tons of natural uranium and over 12 tons of enriched uranium with enrichment ranging from 1.5 percent to 90 percent. All of the uranium supplied by the United States, United Kingdom, and Canada is safeguarded.

For a number of years research has been conducted on the development of processes for the production of heavy water. Although pilot plants were constructed, the Japanese were unable to produce heavy water at a price comparable to that of the United States. Therefore, heavy water needed in the Japanese nuclear energy program has been obtained from the United States under safeguards. The Japanese have produced sufficient reactor-grade graphite for the research reactor program, but the amount required for the first nuclear power station was beyond domestic capability. The graphite for the British-supplied power reactor has been purchased from France. Most of the other basic materials for the nuclear energy

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program either are produced in Japan or can be purchased from other countries through normal commercial channels.

Applications

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Only small quantities of plutonium can be produced by the research reactors in operation or under construction, but the British-supplied power reactor will be able to produce significant amounts of plutonium.

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Research on plutonium has been carried out at both JAERI and AFC to study the use of plutonium for advanced reactors. Construction of a fuel reprocessing plant for the separation of plutonium at the AFC Tokai-mura site began in June 1964 and will not be completed until at least late 1965. The plant is expected to be able to process 0.7 to 1.0 tons of irradiated fuel per day and to handle several types of fuel and cladding.

Japan is interested in developing a method of isotope separation for the production of uranium-235 which would be less expensive under Japanese conditions than the gaseous diffusion process. In 1959 the Institute of Physical and Chemical Research began basic re-

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search on the molecular distillation of uranium-235 and the ultracentrifuge process of isotope separation. Two ultracentrifuge machines were constructed for developmental research, but nothing is known of this work since 1962 when it was transferred to AFC.

The major application of nuclear energy in Japan to date is the use of radioisotopes in research, medicine, and industry. The principal organization for radiation research is the NIRS, but a number of governmental, educational, and industrial organizations also are conducting research using radioisotopes. A considerable quantity of radioisotopes are used for gauging, process control, and nondestructive testing by industry. By 1963, industry had invested over \$15 million directly in isotope work. About one-third of this amount is used for industrial production while the other two-thirds is used for research.

Considerable interest has been shown in developing nuclear propulsion. Since 1956, conceptual designs of more than 20 nuclear propelled ships have been made. In 1963, the Nuclear Ship Development Corporation was established to construct the first Japanese nuclear propelled ship -- an oceanographic research vessel. The long-range program called for design of the ship to begin in 1963 and final testing to be completed in 1973. The present plan is for a 6,350 ton, 10,000 shaft horsepower ship powered by a light-water type reactor having a thermal power of 35 MW.

Japan possesses limited natural energy resources and a long-range plan for the development of nuclear power has been made which calls for the construction of 1,400 MW (electric) of nuclear electrical generating capacity by 1970, and 6,000 to 8,500 MW (electric) by 1980. Japan Atomic Power Company, Ltd. (JAPCO), a joint governmental and industrial company, was established in 1957, and a contract for the construction of Japan's first nuclear power station was concluded with Great Britain in December 1959. Construction of this station, called the Tokai Nuclear Power Station, was started in 1959 at Tokai-mura and is expected to be in operation in 1965. The power station consists of one reactor of the British Calder Hall type and will have an installed electric power capacity of 166 MW (electric). The second JAPCO nuclear power station is to have a U.S. light-water type reactor with an expected installed power capacity in the range of 250 to 300 MW (electric). The reactor probably will not be

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in operation until at least 1970. In addition, three power companies have programs for the construction of nuclear power stations. These programs are still in the early stages of conceptual design, and the stations, if built, probably will not be in operation until 1970 or later.

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NIE 41-65 ADVCON
26 November 1965

NATIONAL INTELLIGENCE ESTIMATE

JAPAN

- Sato's Political Position
- The Domestic Economy
- Foreign Economic Situations
- Military Prospects
- Foreign Policy

NOTE: This is an advance copy of the conclusions of this estimate as approved by the United States Intelligence Board. The complete text will be circulated within five days of this issuance.

Central Intelligence Agency

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CENTRAL INTELLIGENCE AGENCY

26 November 1965

SUBJECT: NIE 41-65: JAPAN

THE PROBLEM

To estimate the political, economic, and foreign policy prospects for Japan over the next two or three years.

CONCLUSIONS

A. Prime Minister Sato's position is probably secure for the period of this estimate. It is unlikely that his conservative majority will shrink significantly in the next lower house elections, which will probably be held in 1966. The major threat to his position is the current business slowdown, but we believe that his administration's fiscal measures and the basic strengths of the economy will prevent further deterioration and permit a modest recovery within a year or so.

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downgrading and
declassification

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B. Another major problem for Sato is his identification with generally unpopular US policies in Vietnam. If extremists who now lead the opposition Socialist Party succeed in exploiting the issue to mount mass demonstrations on the scale of those in 1960, Sato might be forced to resign in favor of another, less identifiably pro-US conservative leader. On balance, however, we believe that the leftists will not succeed in removing Sato with these tactics under foreseeable circumstances.

C. Economic conflicts between Japan and the US will remain, but none has so far caused or is likely to cause any serious or lasting damage to a generally friendly relationship, or jeopardize the political stability of the Sato administration. The main problems in Japanese relations with the US will continue to be those of Communist China, Vietnam, and Okinawa. Japanese trade with Peking will continue to increase, though at a less spectacular rate than in recent months. In 1966, Sato will probably extend credit guarantees to cover exports to Communist China. He will seek to avoid diplomatic recognition of Peking as long as possible; but if Peking gained significant further international recognition, he would probably follow suit, hoping that any impairment of Japan's relationship with Taiwan would be temporary.

D. Japan will continue to rely on the Security Treaty with the US for military protection. While some qualitative improvement is in prospect, there is little chance that Sato will press for any major increases in Japan's own defense forces over the next two or three years. He will

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remain sensitive to public concerns on Vietnam and will continue to oppose the use of Okinawan bases for direct bombing attacks, particularly on North Vietnam. We foresee a growth of Japanese nationalism and self-assurance, which will be reflected in a somewhat more independent policy toward the US on these and other issues, and in a more active political role in general in East Asia.

E. Nonetheless, Japan's initiatives in foreign affairs are apt to be cautious and pragmatic, designed to further its efforts to expand trade in as many directions as possible. Willingness to support plans for development of Southeast Asia will be similarly conditioned; Japan is not prepared to accept US direction on its economic assistance role in the area.

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SPECIAL REPORT

JAPAN RETHINKING SECURITY POLICY

CENTRAL INTELLIGENCE AGENCY
OFFICE OF CURRENT INTELLIGENCE

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JAPAN RETHINKING SECURITY POLICY

For the first time since their devastating defeat in World War II, the Japanese have undertaken a serious and responsible debate on national security. The major aspect of this debate is the degree of defense capability required if Japan is to gain a first-class power status commensurate with its pre-eminence as the fourth industrial power in the free world and the economic leader in the Far East. Government leaders, taking advantage of rising nationalism, are stressing that Japan must make a greater effort to provide for its own defense, while maintaining the US-Japan Mutual Security Treaty as an indispensable adjunct of national security. Nevertheless, Japanese defense planners are still handicapped by the postwar legacy of demilitarization and pacifism.

Present Provision for National Security

Both popular attitudes and constitutional proscription have handicapped the development of Japan's defense. Deep-seated antipathy toward the military arising from the experience of military domination and the shock of defeat in World War II has only recently begun to fade. Pacifism was enshrined in Article IX of Japan's postwar constitution, which bars the maintaining of "land, sea, and air forces, as well as other war potential." This restriction was circumvented beginning with the creation of the National Police Reserve under US occupation aegis in 1950 and the establishment of the Self-Defense Forces four years later. A Supreme Court decision subsequently upheld by implication the legality of these forces, but succes-

sive conservative governments have shied away from attempting to remove the constitutional disability--especially because the combined opposition has the votes to block amendment.

Today the Self-Defense Forces (SDF) consist of about 220,000 men, principally in the Ground Self-Defense Force (GSDF). By policy, however, they are restricted to a purely defensive role, and in fact are considered to have only a limited capability. Military policy does not envision more than a supplementary role for Japan's armed forces in a major conflict. Planning has been based on the belief that successful defense of Japan depends upon US naval and air forces.

The GSDF is capable of preserving internal order, but is largely equipped with obsolescent

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JAPAN'S DEFENSE BUDGET

Fiscal Year *	Million US Dollars	% of Total Budget	% of GNP
1961	509.7	8.7	1.07
1962	593.9	8.3	1.13
1963	687.0	8.1	1.13
1964	764.4	8.5	1.15
1965	837.0	8.2	1.18
1966	946.4	7.9	1.26 (est)

* 1 April-31 March

MANPOWER IN JAPAN'S SELF-DEFENSE FORCES

	Authorized (1965)	Actual (1966)	Planned* (by 1972)
Ground	171,500	148,000	180,000
Maritime	35,500	31,600	41,900
Air	39,500	39,500	42,000
TOTALS	246,500	219,100	263,900

* Under the preliminary draft of the Third Defense Plan, 1967-71 (ending 31 March 1972)

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US-supplied weapons and is inadequate to cope with major aggression.

The Maritime Self-Defense Force (MSDF) has been formally given the mission of defending coastal waters and sea approaches, but its surface force and air arm, despite their modern equipment, are barely adequate to carry out this task.

The Air Self-Defense Force (ASDF) is capable of providing adequate tactical support for both ground and naval forces, but does not have the capability to defend independently against a determined attack by either Communist China or the USSR.

Budget allocations for defense have been consistently parsimonious. While the absolute sums appropriated have mounted yearly, the proportion of the budget devoted to defense has remained near eight percent for the past five years. The armed forces' share of the GNP has barely exceeded one percent, a figure far below the norm for countries of comparable industrial strength.

Japan's defense continues to depend, as it has since 1945, on the US. The terms of the relationship, expressed in the Security Treaty signed in 1952 and revised in 1960, provide the US with important bases in the Far East. Beginning in 1970 the treaty can be revised or terminated on one year's notice. The leftist opposition --principally the Japan Socialist Party (JSP)--last year embarked on a campaign to end the US alliance by 1970. Playing on the public's fears that the treaty will drag Japan into a major war over Vietnam, the JSP is trying to set off disturbances like those it used to bring down the Kishi government in 1960.

In the face of continuing Socialist attacks on the treaty and "American imperialism," Prime Minister Sato has been making increasingly forthright statements about the necessity of continuing the alliance after 1970. He has even hinted that the treaty should be revised to provide for a fixed term rather than possible abrogation on a one-year notice. Although Sato's Liberal Democratic Party

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is deeply split on this issue, the encouragement of public debate emphasizes Sato's confidence that Japanese attitudes have matured on the problem.

New Approaches

The government's willingness to face defense problems reflects the revival of nationalism and the growing realization that Japan is one of the great nations of the world. Japanese policy makers, faced with the hard facts of power, are embarrassed to discover their country regarded internationally as a cipher, dependent upon the US. They want an "independent" posture even though it would probably closely parallel most US policies, to enhance their country's stature in the eyes of its citizens.

However, Sato, although long a nationalist who favored increased defenses, did not consider it politically feasible until late 1965 to support stronger security policies publicly. The way for this new stand was opened by Peking's two nuclear explosions and the crises in Southeast Asia which have obliged the Japanese to think more seriously about security problems. While more heat than light has been generated in the popular debate, at least some Japanese have come to recognize that Japan's voice carries little weight in international councils without military strength to back it up.

Further, the growth of Peking's power and the instability in the Malay archipelago have suggested to a few that Japan must think about defense of its "lifeline" to its markets throughout South and East Asia. About half of Japan's energy resources depend on tankers traversing those waters, and one third of its trade is with the underdeveloped lands there. Naval chief Admiral Tomoharu Nishimura has stressed the need for escorting tankers on Japan's "lifeline" to the Middle East. The reappraisal of Japanese defense policy probably will become more meaningful as Japanese realization of dependence grows.

New Roles for the SDF

Officials charged with planning Japan's defense on a long-range basis face several problems. In trying to forecast needs five years or more hence they must take into consideration the possibility that the Security Treaty may be abrogated at any time after 1970. To have a credible defense substitute available by 1971, Japan would have to embark at once on a major rearmament program, possibly including a nuclear capability. In addition to the political hazards inherent in any nuclear weapons program, a defense buildup will seem wasted to the Japanese if the conservatives continue in control and the treaty remains in force.

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Japan's leaders may be trying to influence popular opinion in favor of a defense buildup by encouraging discussion of SDF missions going beyond the present conception and capability. In August 1965 the director general of the Defense Agency, Raizo Matsuno, lofted a trial-balloon appeal to nationalism by stating that Japan must achieve an independent defense capability by 1975. He claimed that Japan could not depend on the US in case of emergency and that it was "disgraceful" for an independent country to have foreign military installations on its soil permanently. Since then he has continued to call for an independent defense structure in keeping with Japan's advanced status in other fields and has raised the specter of a Chinese Communist nuclear threat.

The acquisition of a nuclear capability, despite continuing public sensitivities, is being increasingly aired as a logical corollary of an independent defense posture. Former chiefs of the services have begun advocating the use of tactical nuclear weapons for defense only and the development of an antimissile capability. Sometimes they justify nuclear arms as necessary to give Japan a strategic deterrent. Admiral Ichizo Sugie, chairman of the Joint Staff Council, reportedly feels that even with the continuation of the US guarantee, Japan as a great power should acquire nuclear weapons.

Conservative Prime Minister Sato has been quite circumspect in reaffirming past renunciation of nuclear arms. He has made it clear, however, that he welcomes the US "nuclear umbrella," although fellow conservatives as well as the leftist opposition have pointed to the inconsistency of renouncing nuclear arms while still depending on them ultimately. He has been careful not to close the door to a future nuclear weapons program.

Two revolutionary proposals for using Japanese forces overseas have received wide attention and some public acceptance inasmuch as they concern subjects close to Japanese hearts--the United Nations and Okinawa. Japanese interest in the UN as the harbinger of world order is strong, and national defense policy calls for support of UN activities. Following Japan's recent election to the Security Council, the raising of the question of cooperation in peacekeeping operations gave the government the opportunity to state that participation in observation-type missions did not contravene the constitution. Considerable leftist opposition, however, persuaded government spokesmen to backtrack somewhat on the question of legal obstacles to participation, and there seems little immediate prospect that such supervisory missions can be authorized without revising present legislation.

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A second possibility for sending troops abroad was advanced by Sato's suggestion that Japanese forces might be used in the defense of Okinawa if US bases there were attacked. The Socialists charged Sato with scheming to violate the constitution by dispatching the SDF to American-administered territory. Socialist obstruction in the Diet influenced Sato to explain that he was merely reflecting a "frank, fraternal expression of Japanese national feeling," and that in fact the constitution, the security treaty, and present SDF laws rule out an exercise of the right of self-defense by Japan on Okinawa. The exchanges nevertheless left the public with the impression of a more "forthcoming" and independent policy for national defense.

Popular Attitudes

The Sato government's failure to disclaim the more extreme statements on military matters indicates its estimate that the public is ready to consider defense problems in a more realistic framework. The relatively quiet public acceptance of the visits by US nuclear-powered submarines to Sasebo illustrates the growing popular tolerance even on nuclear matters. The Socialists, however, continue to emphasize nuclear dangers in pushing the "peace" theme on which they have depended so heavily in the past to develop "mass" appeal. They have recently accused the Sato government of "stockpiling" legal precedents through its stepped-up program of visits by nuclear-powered vessels and of planning to add visits by

nuclear-powered aircraft carriers. The Socialists claim that the government is trying to prepare the public for the introduction of nuclear arms.

The government's effort to isolate the Socialists by appealing to the more moderate opinion groups appears to be having some success. There have been recent indications that elements within the opposition parties (particularly the small Democratic Socialist and the Buddhist Komeito) acknowledge the value of the US role in Japan's defense. In fact, [redacted] Soka Gakkai, Komeito's parent organization, [redacted] despite Komeito's public stand for nonalignment in foreign policy, [redacted] not only supported the present security system but also felt that Japan should eventually have nuclear arms. Public opinion polls reveal a growing acceptance of the SDF and of Japan's alignment with the free world, although a strong minority still resists both of these.

Even among Japanese who accept the need for defense forces there are many who believe that Japan's rising standard of living, made possible by minimum defense outlays, has enabled the country to avoid Communism, and that this should not be jeopardized by substantial increases in defense spending. Most Japanese, in fact, probably prefer that the US guarantee their security and spare them the expense, risk, and responsibilities involved. They argue that Japan cannot afford the effort to provide

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a nuclear capability of its own and should rely on the US "umbrella." Many, however, would be willing to support a greater Japanese defense effort to bring about the removal of US bases but wish to retain the US guarantee of security.

More nationalistic overtones have appeared among groups who may have taken their cue from Defense Agency chief Matsuno's remarks last summer. They find dependence on the US "humiliating," demand a completely independent defense effort, and are willing to pay the costs. Some of them advocate the development of an independent nuclear capability, although their timing for such a program is unclear at present.

Increased Defense Effort and The Third Defense Plan

Official and public discussion of the defense problem suggests general support for the limited buildup envisaged under the prospective five-year Third Defense Plan, the draft of which is being prepared by the Defense Agency for submission to the National Defense Council by June 1966. For the last year of the present Second Defense Plan (1962-1966), the SDF received a sizable budgetary increase--13 percent over the appropriation for fiscal 1965--but rising costs will make it much less in real terms. Nevertheless, the

plan will be completed fairly close to its targets.

As now drafted the Third Defense Plan, to be launched in April 1967, calls for a somewhat greater effort in the provision of firepower, mobility, and general modernization, and the improvement of air and antisubmarine defense. A major suggested innovation creates small reserves for the air and maritime defense forces in addition to those for the ground forces. For the latter, the draft retains the same authorization as the Second Defense Plan for 180,000 personnel, but this may well remain academic since the less prestigious ground forces have continuing problems in recruiting and retaining personnel.

Three major goals of the present proposal are (1) correction of deficiencies in the SDF; (2) development of a domestic industrial defense base; and (3) raising budget appropriations progressively to the level of two percent of the GNP. The total cost of the package has been estimated at \$7.5 billion, a figure more than double that for the previous plan.

While the anticipated buildup will increase the credibility of Japan's defense efforts, the modest modernization possible under the limitation to two percent of GNP is quite inadequate

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to relieve the US of its responsibilities for Japan's defense. The government continues to count on the Security Treaty for Japan's defense and considers the continuing offer of bases to the US the least it can do in the absence of a constitutional sanction for participating more fully in a truly common defense.

If present trends in public opinion continue to move as rapidly and in the same direction as they have over the past few months, however, it may prove possible to go beyond present limitations before the period of the Third Defense Plan is completed. ~~(SECRET NO FOREIGN DISSEM)~~

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DIST 20 MAY 1966

COUNTRY: JAPAN VIETNAM FRANCE BRITAIN ITALY

DOI: APRIL-MAY 66

SUBJ: STATEMENTS TO JAPANESE PEACE ENVOY YOKOYAMA
ON VIETNAM BY WESTERN EUROPEAN GOVERNMENT
OFFICIALS AND THE VATICAN

APPROVED FOR RELEASE
DATE: MAY 2001

ACQ:

SOURCE:

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3.4(h)(1)-25
EO 12058
3.4(h)(1)-25
(C)

1. ACCORDING TO A [REDACTED] REPORT

[REDACTED] ON THE YOKOYAMA MASAYUKI PEACE MISSION TO EUROPE AND
ASIA, YOKOYAMA MET WITH FRENCH FOREIGN MINISTER COUVE DE MURVILLE
AND ASIAN BUREAU DIRECTOR MANA'CH DURING HIS VISIT TO PARIS (LATE
FEBRUARY AND EARLY MARCH). COUVE DE MURVILLE TOLD YOKOYAMA THAT
IT IS NOT USEFUL FOR THE UNITED STATES TO CONTACT THE SOVIET UNION
OR OTHER THIRD COUNTRIES IN AN EFFORT TO SETTLE THE VIETNAM CON-
FLICT. ACCORDING TO MURVILLE, THE UNITED STATES SHOULD CONTACT

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NORTH VIETNAM AND THE NATIONAL LIBERATION FRONT DIRECTLY. IF JAPAN DESIRES TO CONTRIBUTE TOWARD PEACE IN VIETNAM, JAPAN MUST ASK THE UNITED STATES TO MAKE CONCESSIONS TOWARD BOTH NORTH VIETNAM AND THE VIET CONG. MURVILLE ALSO STATED THAT FRANCE IS NOT CONSIDERING ANY CONCRETE PLAN FOR SOLUTION OF THE VIETNAM CRISIS BECAUSE A SOLUTION DOES NOT APPEAR IMMINENT.

2. ASIAN BUREAU DIRECTOR MANA'CH STATED THAT BEFORE VIETNAM PEACE NEGOTIATIONS CAN BE UNDERTAKEN, THE FOLLOWING IMPORTANT POINTS MUST BE CONSIDERED AND ACCEPTED BY THE UNITED STATES:

- A. PARTICIPATION OF CHINA IN A PEACE CONFERENCE ON VIETNAM;
 - B. CESSATION OF UNITED STATES BOMBING OF NORTH VIETNAM;
 - C. INDEPENDENT PARTICIPATION OF THE VIET CONG IN THE PEACE CONFERENCE SEPARATE FROM NORTH VIETNAMESE PARTICIPATION.
- COMMENTING ON CHINA'S ATTITUDE ON VIETNAM, MANA'CH STATED THAT, ALTHOUGH CHINA HAS URGED NORTH VIETNAM AND THE VIET CONG TO CARRY ON THE LIBERATION STRUGGLE, FINAL SETTLEMENT OF THE PROBLEM WILL BE BY THE NORTH VIETNAMESE AND VIET CONG THEMSELVES.

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3. IN LONDON [REDACTED] YOKOYAMA MET WITH BRITISH FOREIGN SECRETARY MICHAEL STEWART, WHO STATED THAT THE BRITISH GOVERNMENT

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(classification)

(dissem controls)

IS NOT STICKING TO THE FORMALITIES OF THE 1954 GENEVA CONFERENCE SINCE IT CONSIDERS THAT OTHER COUNTRIES COULD NOW PARTICIPATE IN A NEW CONFERENCE ON VIETNAM. ALSO BRITAIN CONSIDERS THAT THE NEUTRAL NATIONS CAN PLAY AN INTERMEDIARY ROLE IN BRINGING THE COMMUNISTS TOWARD ACCEPTING PEACE NEGOTIATIONS.

4. IN ROME, YOKOYAMA MET WITH ITALIAN FOREIGN MINISTRY DIRECTOR OF POLITICAL AFFAIRS GAJA (PHONETIC) WHO STATED THAT ITALY'S POSITION ON VIETNAM IS CLOSE TO THAT OF BRITAIN. ITALY, BECAUSE OF INTERNAL POLITICAL FACTORS, CANNOT UNDERTAKE ANY INITIATIVE OR ACTIVE ROLE IN BRINGING ABOUT A PEACEFUL SETTLEMENT OF THE VIETNAM PROBLEM, GAJA SAID. YOKOYAMA ALSO MET WITH POPE PAUL [REDACTED] WHO STATED HIS BELIEF THAT JAPAN WILL BE THE SOLE NATION WHICH CAN HAVE AN EFFECTIVE ROLE IN BRINGING A VIETNAM SETTLEMENT. ALTHOUGH THE VATICAN'S APPEAL FOR PEACE DID NOT BRING ANY RESULTS, POPE PAUL ADDED THAT HE HAS NOT ABANDONED HIS EFFORTS.

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5. [REDACTED] DISSEM: CINCPAC PACFLT PACAF ARPAC STATE [REDACTED]

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DIRECTORATE OF
INTELLIGENCE

Intelligence Report

*Japan's Economic Role
in the Development of Free Asia*

~~Confidential~~

No. 10

APPROVED FOR RELEASE

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RR IR 67-12
May 1967

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CONTENTS

	<u>Page</u>
Summary	1
I. Postwar Japanese Economic Aid	7
A. The Flow of Japanese Capital	7
B. The Pattern of Aid and Investment Activities	8
1. Official Aid	8
2. Private Capital Flows	15
C. Factors Inhibiting Increases in Aid	16
II. Japanese Aid to Free Asia	23
A. The Region's Share of Japanese Aid and Investment Activities	23
B. The Japanese Role in National Development Activities	26
1. Official Aid Activities	27
2. Private Investment Activities	37
C. The Japanese Role in Regional Development Activities	41
III. Japanese Trade with Free Asia	47
A. Magnitude and Growth	47
B. Commodity Composition	51
IV. Prospects for Japanese Economic Leadership in Free Asia	59
A. The Outlook for Increased Japanese Aid	59
B. The Future of Japanese Trade with Free Asia	62

Tables

	<u>Page</u>
1. Flow of Japanese Long-Term Capital to the Less Developed Countries and Multilateral Agencies, 1950-65	8
2. Japan: Grant Aid to Free Asian Countries, 1950-65	24
3. Japan: Some Uses of Reparations and Official Aid to Free Asia as of 31 March 1966	30
4. Japan: Academic and Technical Training of Free Asians, Total for 1954-66	34
5. Fields of Instruction of Free Asian Academic Students and Technical Trainees in Japan, 1965	35
6. Stock of Japanese Private Direct Investment in Free Asia as of March 1960	40
7. Net Flow of Japanese Private Direct Investment to Free Asia, Total for 1963-65	40
8. Japanese Trade with Free Asian Countries, 1960-65	48
9. The Japanese Share of the Market in Free Asian Countries, 1960 and 1965	50
10. Commodity Composition of Japanese Trade with Free Asia, 1960-65	52
11. Share of Free Asia in the Japanese Market for Selected Commodity Imports, 1960-65	56

Illustrations

	<u>Page</u>
Figure 1. Japan: Chronology of Aid to Less Developed Countries (chart)	11
Figure 2. Japan: Selected Aid Projects in Free Asia (photographs)	29
Figure 3. Japan: "Nonproject" Aid to the Philippines (photograph)	33
Figure 4. Training in Japan of Students and Technicians from Free Asian Countries (photographs) . . .	34
Figure 5. Japan: Overseas Technical Assistance to Free Asian Countries (photographs)	36
Figure 6. Japan: Some Lines of Private Investment in Free Asia, 1945-66 (chart)	39
Figure 7. Japan: Prime Minister Sato Addressing the Southeast Asian Ministerial Conference in Tokyo in April 1966 (photograph)	44
Figure 8. Manufacturing Output in Japan Compared with Minerals Output in Free Asia, 1960-65 (chart)	54
Figure 9. Japan: Rolling Stock Exported to Free Asia (photographs)	54

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JAPAN'S ECONOMIC ROLE IN THE DEVELOPMENT
OF FREE ASIA*

Summary

The Japanese government is groping for a foreign aid policy that is consistent with the nation's new status as one of the world's industrial leaders and an important member of the community of advanced nations. Until quite recently, official Japanese aid to Free Asia centered on reparations, which were treated by Japan as obligations to be discharged as expeditiously as possible. Particularly since 1965, the Japanese government has developed a more positive approach to foreign aid, which has increasingly reflected an awareness of the long-run benefits to Japan of economic development in Free Asia.

Between 1950 and 1965 the flow of long-term capital** from Japan to the less developed countries amounted to some \$2.6 billion, and activity during 1966 will probably raise this total to \$3.1 billion. About \$1.8 billion of the flow through 1965 as well as probably another \$300 million in 1966 were accounted for by official disbursements, the most important element of which consisted of the programs of reparations to a number of countries

* This report was produced solely by CIA. It was prepared by the Office of Research and Reports and coordinated with the Office of Current Intelligence; the estimates and conclusions represent the best judgment of the Directorate of Intelligence as of April 1967.

The term Free Asia is used throughout this report to denote the non-Communist Asian countries extending from Afghanistan eastward through South and Southeast Asia and north from there to South Korea. Australia and New Zealand are not considered parts of the region for the purposes of this report.

** The expression long-term capital is used throughout this report to denote official and private capital flows involving repayment over periods of five years and more, although in some recent years data on private capital reflect only flows involving repayment terms of more than five years. Because of frequent changes in classification of data by both the Japanese government and the principal international organizations reporting economic assistance, the reader may encounter a variety of related data differing from that shown in this report. Insofar as possible conflicting series of data have been adjusted for this report to adhere to the standard described above, and differences with other reports represent the selection of other criteria for long-term capital.

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of Free Asia. As these programs draw to a close, considerable attention is being focused on whether Japan will be able so to increase its flow of official grants and loans,* contributions to multilateral agencies, and private investment and export credits as to provide the 1 percent of national income that the Sato administration regards as its goal in these forms of development assistance. In addition to the usual impediments to foreign aid, Japan faces some peculiar obstacles, including low per capita income, particularly strong competing demand for domestic investment, and pronounced rivalries among the ministries that are concerned with aid planning.

Free Asia has been the principal beneficiary of Japanese development assistance, with annual flows of long-term capital to the region increasing from an estimated \$125 million in 1960 to an estimated \$265 million in 1965. The Free Asian share in the various forms of long-term assistance has varied from almost the complete amount of grant aid to about a third of the private capital flow. All of the countries of the region have received at least some long-term capital from Japan, and in a number of cases this assistance has been noteworthy. In Burma, Indonesia, and the Philippines, reparations have been principal sources of grant aid. Official bilateral credits extended by Japan through consortia have been significant sources of development capital for India and Pakistan. A large program of official and private assistance to South Korea and bilateral credits to Nationalist China and Malaysia will give Japan a prominent role in the present development plans in those countries.

Japan has made important official contributions in project and non-project aid to the rehabilitation and development of Free Asia. Particularly noteworthy among the project assistance is infrastructure such as the Balu Chaung hydroelectric dam in Burma and the Da Nhim hydroelectric dam in South Vietnam and assistance to heavy industry such as the construction of fertilizer plants in India and steel plants in India and Pakistan. Among other official assistance that has been especially significant to development efforts is the supply of capital equipment for manufacturing facilities and agriculture and transportation equipment in the form of ships, railroad rolling stock, automobiles, and trucks. These programs of material aid have been complemented by extensive

* Following common usage, the terms loan and credit are used interchangeably in this report. It should be noted that virtually all Japanese "loans" have been suppliers' credits in the sense that they have been tied to procurement in Japan.

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Japanese participation in technical assistance and by academic training through official Japanese channels, multilateral programs, or activities of the private sector.

In addition to providing increasing amounts of official bilateral aid to Free Asia, Japan has been an important source of numerous small private investment activities for the region. Thailand is clearly the principal beneficiary of this form of long-term capital, and a conservative estimate would put the total stock of Japanese capital in that country at \$35 million. Other major areas of private investment for Japan are Indonesia, Singapore, and Malaysia, the last of which is the recipient of assistance in the construction of a steel mill that represents one of the major Japanese private investments in heavy industry in Free Asia. Especially in the case of the numerous investments in minerals and forestry in Indonesia, production-sharing has been an important means by which the Japanese have overcome obstacles to the entry of private capital into the less developed countries, and this form of investment will probably continue to play an important role in overseas Japanese economic activities.

The importance to Free Asia of trade with Japan is steadily increasing as the Japanese market share expands in most of the less developed countries of the region, and rapid growth of the Japanese economy will continue to provide an important source of demand for many of Free Asia's primary products. Nevertheless, because Japan's growth rates in output and trade are greater than those of the region as a whole, the share of Free Asia in Japanese imports and exports is shrinking. Thus, between 1955 and 1965, the share of Japanese imports coming from Free Asia fell from 27 percent to 17 percent, and a similar relative decline occurred in exports. Although there is every reason to believe that Japan will remain competitive in the heavy industrial exports to the region that have spurred its advance in the Free Asian market, the prospects for a complementary growth in the Free Asian share of Japanese imports of raw materials are not as promising. Production difficulties in Free Asia and Japanese emphasis on a wide distribution of sources of low-priced raw materials militate against a substantial rise in the Free Asian share of the Japanese market for such raw materials as sawlogs, iron ore, bauxite, and crude oil. Rapid expansion in Japanese imports of certain tropical foodstuffs suggests that there may be more growth potential in these commodities as the Japanese diet continues to diversify.

Although Japan is a major industrial power and the most economically advanced of the Asian countries, efforts of the more progressive elements

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of the Japanese government to assume active leadership in the development of Free Asia have been inhibited by at least two major factors, the future impact of which is still uncertain. The first of these, which is most prevalent in government circles, is anxiety over animosities throughout Free Asia lingering from World War II. The second impediment to a more active role in Asian economic leadership is the fact that the Japanese people, whose standard of living is still relatively low on the European scale, have only recently become aware of Japan's advanced economic status. Moreover, strong domestic demand for public investment will continue to compete with foreign aid, and a coherent Japanese aid policy remains to be developed. Nevertheless, the declared goal of 1 percent of national income for the annual flow of long-term capital from Japan to the less developed countries probably will be achieved by 1970. At a rate of growth of 8 percent for national income, this would mean a flow in that year of \$1 billion in 1965 prices, and of this amount \$600 million or more might be expected to go to Free Asia. Grant aid is not likely to be expanded much beyond its present scale, but a growing share of the official bilateral assistance to Free Asia will probably take the form of credits on terms softer than the interest rate of slightly less than 6 percent characteristic of the past. Japan's growing awareness of the increasing competitiveness of its heavy industrial products will probably lead to more enthusiasm for disbursement of aid through such multi-lateral channels as special funds of the Asian Development Bank and the Mekong Commission. The geographic distribution of official economic aid to Free Asia in 1970 is likely to show a relative concentration in East and Southeast Asia as opposed to South Asia, but Japan will probably continue to play a constructive role in the conscriptions for India and Pakistan. Private investment will probably focus on Thailand, Indonesia, Singapore, and Malaysia, but improvements in the climate for Japanese investment in the Philippines and South Korea could mean significant growth in private capital flows to those countries.

The outlook for Japanese trade with Free Asia is strongly conditional on foreign aid to the region. Although Japan will probably continue to expand to some extent its market shares in the trade of the less developed countries of Free Asia, sustained growth in Japanese exports to the region will require the increased purchasing power that can only come from economic development. The Japanese are becoming distinctly more aware that their traditional conception of foreign aid as primarily a means of direct export promotion is too narrow and that Japan stands to benefit greatly from the growth-stimulating effects of both its own and other aid programs in the area.

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Viewed from the perspective of the less developed countries of Free Asia, the crucial trade issue is how to increase Japanese imports from the region to help overcome large bilateral trade deficits. Among the factors liable to influence the expansion of these imports, the most significant appears to be the stimulation of production in Free Asia of raw materials for heavy industry. The most direct means to achieve this end is a so-called "development and import formula" employed by the Japanese. Because this approach has involved a considerable measure of Japanese government support for the foreign investment activities of the private sector, its continued application will probably elicit increased anxiety on the part of the press and investors in the other advanced countries for what some of them see as Japanese exploitation of Free Asia and an attempt to reestablish the Greater East Asia Co-Prosperity Sphere. This anxiety appears unwarranted, however, for it is clearly not in the national interest of Japan to establish any significant proprietary role in the region's economies at a time when it is seeking to broaden its sources of supply of raw materials and its exports are benefiting from regional growth stimulated by capital assistance from other advanced countries.

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I. POSTWAR JAPANESE ECONOMIC AID

A. The Flow of Japanese Capital

From 1950 through 1965 the flow of long-term capital from Japan to the less developed countries totaled some \$2.6 billion. As can be seen in Table 1, this flow averaged about \$300 million annually from 1960 through 1965 and, for the most part, has been significantly less than the Sato administration's goal of 1 percent of national income per annum. In 1966 the total was probably between \$500 million and \$520 million, while 1 percent of the national income would have amounted to almost \$800 million in current prices.

Despite the common practice of calling total flows of long-term capital "economic aid," these data reflect a wide array of capital transactions, such as reparations payments and official grants, official development loans, various private direct investments, and private and official export credits on relatively hard commercial terms. Of the total capital flow of \$2.6 billion from 1950 through 1965, about \$1.8 billion was made up of net official disbursements, distributed among the various major kinds of aid as follows:

	<u>Million US \$</u>
Official grant aid (including reparations)	835
Official loans*	865
Net contributions to multilateral agencies	135

As much as \$300 million more in official aid may have been disbursed in 1966, of which about \$100 million is accounted for by grants.

* For the purpose of long-term comparisons, data on official and private credits in this report reflect a series of definitions in use by the Japanese government through 1965. Because changes in these definitions have led to partial revision of the allocation of credit disbursements between the public and private sectors, the reader may encounter reports on official or private credit disbursements since 1962 in other sources that do not agree with the data in this report. Since the problem is simply one of allocating capital flow between sectors, these differences have no effect on the total annual flows of aid in any report using the criteria described in the second footnote on p. 1, above.

Table 1

Flow of Japanese Long-Term Capital
to the Less Developed Countries and Multilateral Agencies a/
1950-65

	<u>Total Net Capital Flow</u>		<u>Net Official Flow (Million US \$)</u>
	<u>Million US \$</u>	<u>As a Percent of National Income</u>	
1950-55 (annual average)	15		10
1956	109	0.53	94
1957	109	0.47	92
1958	310	1.34	285
1959	171	0.64	152
1960	229	0.71	126
1961	371	0.97	214
1962	281	0.66	165
1963	265	0.54	171
1964	245	0.44	179
1965	414	0.61	302

a. Data exclude private export credits for periods of less than five years through 1959 and private export and official bilateral credits of less than five years since the beginning of 1960. Because of the initial inclusion of some capital transactions not generally regarded as aid, this series of data has been revised and reclassified a number of times since Japan joined the Development Assistance Committee of the Organization for Economic Cooperation and Development in 1961. Although further revisions occurred in 1966, the data shown above are based primarily on the system of classification in use in 1965 in order to preserve comparability within the timespan being discussed.

B. The Pattern of Aid and Investment Activities

1. Official Aid

The reparations programs were the first and most important phase of the official Japanese effort in the postwar period to provide

long-term capital to less developed countries.* This phase of Japanese development assistance began with the San Francisco Treaty, which provided for bilateral negotiations on the reparations issue. As can be seen in the chronology (see Figure 1), negotiations on reparations between Japan and the affected nations** began in 1951 and continued intermittently through the settlement of outstanding issues with Singapore in October 1966.

Grant commitments under various programs of reparations and indemnifications, including those in the "normalization" agreement with South Korea, have totaled over \$1.5 billion. Actual disbursements were some \$785 million through 1965. Grants extended "in lieu of reparations" or in place of further reparations have amounted to an additional \$147 million. Finally, official loan commitments associated with the broad category of indemnification have added more than another \$1.0 billion, but this type of aid has seen only limited use so far. Although more than half of the regular reparations grants have been disbursed so far, remaining obligations for this or related grant aid are still large in the cases of the Philippines, Burma, and South Korea; and the influence of indemnifications on Japanese aid programs and policies, although diminishing rapidly, will be present well past 1970.

Thus far, official economic aid not related to reparations and indemnification has, for the most part, centered on government-to-government agreements for yen credits and on suppliers' credits for more than five years extended by the Export-Import Bank of Japan. Although pertinent data are notably misleading prior to 1960 and inconsistent since then, the disbursement of some \$200 million for 1965 probably represents a tripling of net annual disbursements under such credits since the late fifties. Japanese policy on credit assistance to less developed countries has undergone a number of basic changes since 1957. In that year the scope of activities of the Export-Import Bank of

* An alternative position would be that reparations do not constitute conventional economic aid. Nevertheless, because Japanese reparations have been an important source of foreign capital for development and have been included within "official grant and grant-like contributions" in aid reviews by the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD), they are treated as economic aid in this report.

** Among the Asian nations entitled to reparations, Nationalist China, India, Cambodia, and Laos waived their rights to such settlement.

JAPAN: CHRONOLOGY OF A

- 1951: SAN FRANCISCO PEACE TREATY (SEPTEMBER)
REPARATIONS TALKS BEGIN WITH INDONESIA
- 1952: ASSOCIATE MEMBERSHIP IN ECONOMIC COMMISSION FOR ASIA AND THE FAR EAST (ECAFE)
(JANUARY)
REPARATIONS TALKS BEGIN WITH THE PHILIPPINES (JANUARY)
- 1953: FULL MEMBERSHIP IN ECAFE (APRIL)
CABINET ANNOUNCES THREE-POINT PROGRAM OF ECONOMIC COOPERATION WITH SOUTHEAST
ASIA (DECEMBER)
- 1954: REPARATIONS TALKS BEGIN WITH BURMA (AUGUST)
FULL MEMBERSHIP IN THE COLOMBO PLAN (OCTOBER) AND FIRST POSTWAR TECHNICAL
ASSISTANCE TO SOUTHEAST ASIA THROUGH THAT ORGANIZATION
REPARATIONS AGREEMENT SIGNED WITH BURMA (NOVEMBER)
- 1955: BURMA REPARATIONS AGREEMENT BECOMES EFFECTIVE (APRIL)
SETTLEMENT AGREEMENT ON SPECIAL YEN PROBLEM SIGNED WITH THAILAND FOR \$15 MIL-
LION IN CASH AND \$26.7 MILLION IN LOANS (JULY)
- 1956: PHILIPPINES REPARATIONS AGREEMENT SIGNED (MAY)
PHILIPPINES REPARATIONS AGREEMENT BECOMES EFFECTIVE (JULY)
- 1957: JAPAN DECLARES INTENTION TO ASSIST MEKONG DEVELOPMENT SCHEME (MARCH)
OVERSEAS INVESTMENT INSURANCE SYSTEM REVISED TO COVER LOSSES THROUGH NAT-
IONALIZATION AND TO INCLUDE COVERAGE FOR CAPITAL REPATRIATION PROBLEMS (MAY)
EXPORT-IMPORT BANK LAW REVISED TO ALLOW BROADER RANGE OF OVERSEAS
ACTIVITIES (MAY)
- 1958: INDONESIA REPARATIONS AGREEMENT SIGNED (JANUARY)
FIRST GOVERNMENT-TO-GOVERNMENT CREDIT AGREEMENT (\$50 MILLION) CONCLUDED WITH
INDIA (FEBRUARY)
INDONESIA REPARATIONS AGREEMENT BECOMES EFFECTIVE (APRIL)
LAOS GRANT AID ("IN LIEU OF REPARATIONS") AGREED TO (OCTOBER)
- 1959: LAOS GRANT AID ("IN LIEU OF REPARATIONS") BEGINS (JANUARY)
CAMBODIA GRANT AID ("IN LIEU OF REPARATIONS") AGREED TO (MARCH)
VIETNAM REPARATIONS AGREEMENT SIGNED (MAY)
CAMBODIA GRANT AID ("IN LIEU OF REPARATIONS") BEGINS (JULY)

FIGURE 1

AID TO LESS DEVELOPED COUNTRIES

- 1960: SOUTH VIETNAM REPARATIONS AGREEMENT BECOMES EFFECTIVE (JANUARY)
 ASIAN ECONOMIC RESEARCH INSTITUTE, ORGANIZED IN 1958 (NOVEMBER), BECOMES
 SEMIGOVERNMENTAL ORGANIZATION WITH \$ 1 MILLION TO \$ 2 MILLION ANNUAL BUDGET
- 1961: OVERSEAS ECONOMIC COOPERATION FUND (OECF) ESTABLISHED TO PROVIDE CREDITS ON
 MORE LIBERAL TERMS TO DEVELOPING COUNTRIES (MARCH)
 JAPAN ADMITTED TO THE DEVELOPMENT ASSISTANCE COMMITTEE OF THE ORGANIZATION
 FOR ECONOMIC COOPERATION AND DEVELOPMENT (OECD) (SEPTEMBER)
 FIRST GOVERNMENT-TO-GOVERNMENT CREDIT EXTENDED TO PAKISTAN (NOVEMBER)
- 1962: SPECIAL YEN AGREEMENT WITH THAILAND MODIFIED TO CONVERT LOAN PORTION OF
 SETTLEMENT TO GRANT AID (JANUARY)
 OVERSEAS TECHNICAL COOPERATION AGENCY (OTCA) SET UP TO COORDINATE ALL
 OFFICIAL AND PRIVATE TECHNICAL ASSISTANCE EFFORTS (JUNE)
- 1963: AGREEMENT ON ECONOMIC AND TECHNICAL COOPERATION INVOLVING \$140 MILLION IN
 GRANTS SIGNED WITH BURMA (MARCH)
- 1964: EXPORT-IMPORT BANK LAW REVISED TO PROVIDE FOR REFINANCING LOANS TO DEVELOP-
 ING COUNTRIES WITH BALANCE-OF-PAYMENTS PROBLEMS (MARCH)
- 1965: JAPAN MAKES FIRST CONTRIBUTION TO FOREIGN EXCHANGE OPERATIONS FUND FOR
 LAOS (APRIL)
 JAPAN AGREES TO \$150 MILLION CREDIT FOR NATIONALIST CHINA (APRIL)
 JAPAN SIGNS NORMALIZATION AGREEMENT WITH SOUTH KOREA PROVIDING FOR \$800 MIL-
 LION IN GRANTS, CREDITS, AND INVESTMENTS (JUNE)
 FIRST GROUP OF JAPAN OVERSEAS COOPERATION VOLUNTEERS ("PEACE CORPS") SENT TO
 LAOS (DECEMBER)
- 1966: JAPAN PLEDGES CONTRIBUTION TO NAM NGUM DEVELOPMENT FUND UNDER MEKONG
 SCHEME (MARCH)
 JAPAN CONVENES SOUTHEAST ASIAN MINISTERIAL CONFERENCE TO DISCUSS ECONOMIC
 DEVELOPMENT IN REGION (APRIL)
 EMERGENCY CREDIT OF \$30 MILLION EXTENDED TO INDONESIA (MAY)
 JAPAN SUBSCRIBES \$200 MILLION TO CAPITAL OF ASIAN DEVELOPMENT BANK (JULY)
 JAPAN CONVENES MEETING OF INDONESIAN CREDITORS IN TOKYO (SEPTEMBER)
 REPARATIONS AGREEMENT CONCLUDED WITH SINGAPORE (OCTOBER)
 OFFICIAL BILATERAL CREDIT FOR \$50 MILLION EXTENDED TO MALAYSIA (NOVEMBER)
 JAPAN CONVENES CONFERENCE ON AGRICULTURAL DEVELOPMENT IN SOUTHEAST ASIA
 (DECEMBER)

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Japan was enlarged to permit a wider range of credit activities involving foreign governments and foreign corporations. Following this liberalization of credit policy, the Export-Import Bank entered into its first major government-to-government credit, a so-called "special yen agreement" for a long-term credit of \$50 million to India in February 1958; and this sort of loan activity has expanded rapidly since then.

The necessarily high interest rates charged by the Export-Import Bank impede credit assistance to less developed countries. To help overcome this obstacle, the Japanese government created the Overseas Economic Cooperation Fund (OECF) in March 1961. This organization, initially authorized a capital fund of \$47 million, was set up under the Economic Planning Agency to provide credits with provisions for repayment over 20 years (including five-year grace periods) and interest rates of 3.5 percent or less. Although the OECF is authorized to loan directly to foreign governments or foreign firms, no such loans were extended until mid-1966, and its funds had instead been disbursed primarily to Japanese firms engaged in development projects.

Among important developments in the OECF in 1965 were a significant increase in disbursements, increases in capitalization, changes in the OECF law permitting domestic borrowing and the issuance of bonds, and provisions for a total of roughly \$250 million in official credits for South Korea and Nationalist China to be disbursed through the OECF at relatively liberal terms.^{*} By the end of 1965, loans outstanding (that is, disbursements less repayments) under the OECF amounted to \$37.7 million, and total commitments were \$57.4 million at the end of January 1966. A sum of \$20.8 million was appropriated in the Japanese budget for Fiscal Year (FY) 1966^{**} as a capital subscription to the OECF. A like sum was authorized for lending to the OECF by the Trust Fund Bureau during FY 1966 to help meet the OECF's growing requirements, but there was general recognition among the ministries and agencies concerned with foreign aid that continued borrowing of this sort could prejudice the low interest rates of OECF loans. The Director of the OECF Loan Department has estimated that only about \$2.8 million would be borrowed by the OECF in FY 1966.

^{*} The credits to South Korea and Nationalist China are the first cases in which the OECF actually has authorized terms as liberal as 3.5 percent interest with repayment over 20 years, the most liberal terms through March 1965 having been 5.5 percent and 12 years.

^{**} The Japanese fiscal year begins on 1 April of the year specified.

Net contributions to multilateral agencies have been the principal remaining category of official Japanese capital flows classified by the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD) as economic aid. From 1950 through 1965 this category accounted for some \$135 million, or about 7 percent of the total flow of official Japanese capital to the less developed countries. Included in it were grants to various international agencies and subscriptions to the International Bank for Reconstruction and Development (IBRD) and its affiliated organizations. In 1965 these net contributions totaled \$17.5 million, but a special increase in the capital of the IBRD and an initial payment of \$20 million on a capital subscription of \$200 million to the Asian Development Bank probably raised the figure to almost \$50 million for 1966.

Special note should be taken of the small but increasing role played by technical and academic assistance in Japan's official and private aid programs. Disbursements of official bilateral grants for technical cooperation (other than the limited amounts under reparations) totaled only \$24.5 million from 1960 through 1965, but over the period the annual disbursements grew from \$2.2 million to \$6.0 million. The Japanese government has frequently argued that Japan has a distinct contribution to make in the area of technical assistance, and this attitude will probably be reflected in the continued growth of technical cooperation grants.

The creation of the Overseas Technical Cooperation Agency (OTCA) under the Ministry of Foreign Affairs in June 1962 was an important step forward in the coordination of public and private technical assistance programs.* Programs of the public and private sectors supervised or coordinated by this agency include training in Japan, the dispatch of Japanese experts to less developed countries, the establishment and operation of overseas technical training centers, and the preparation of feasibility studies. In 1965 the OTCA broadened its activities through the creation of a Japanese Peace Corps, known officially as the Japan Overseas Cooperation Volunteers (JOCV). Budgetary appropriations for technical cooperation in FY 1965 and 1966 covering the activities of the OTCA and various subsidies for private technical aid amounted to \$7.5 million and \$9.4 million, respectively.

* Even before this, however, the Japanese government subsidized much of the nominally private activity in this field.

2. Private Capital Flows

Disbursements of private loans and investments have accounted for a considerable share of the flow of Japanese long-term capital to the less developed countries. Totalling over \$750 million from 1950 through 1965, these disbursements have accounted for about 30 percent of the total net flow. These figures for private assistance include direct investment in developing countries, net private trade credits of over five years, and portfolio investments in multilateral agencies. Of these categories, direct investment, which amounted to two-thirds of the net private capital flow from 1961 through 1965, is the most significant; but the relatively volatile category of trade credits has also been an important component in the private capital flow.*

The cumulative value of Japanese private direct investment in productive activities** in the less developed countries since 1951 was in excess of \$580 million at the end of March 1966. The flow of this amount was in no small measure facilitated by Export-Import Bank credits that in some instances provided up to 50 percent of the value of project costs directly to Japanese firms and through them to foreign partners. Various institutional measures such as the Export Proceeds Insurance Scheme, the Overseas Investment Principal Insurance System, and the Overseas Investment Profit Insurance Program also have contributed to an improved climate for private credit and investment activities abroad, but Japanese businessmen are still quite apprehensive about political and economic uncertainties in the developing countries.

Such Japanese private direct investment abroad as has taken place so far has followed three basic patterns. The two most prevalent are those in which the Japanese party to an agreement acquires stock in a foreign firm by supplying capital, technology, or cash and those in which the Japanese investor extends credits for basic funds for equipment or working capital in exchange for claims for subsequent repayment in cash or through production-sharing. The second arrangement usually produces a long-term relationship tantamount to equity investment. Though it may provide less

* Using the new definitions adopted by the Japanese government in 1966, direct investment accounted for 47 percent and private trade credits for 53 percent of the private long-term capital flow from Japan to the less developed countries from 1962 through 1965.

** That is, enterprises other than commercial facilities for Japanese exports and overseas branches of Japanese firms.

Japanese control over a firm's operations, this arrangement is often used to get around the various restrictions imposed on foreign investments in the underdeveloped countries and to reduce the risk of losses through nationalization. A third and less frequent method of investment abroad, the most notable example of which is the Japanese-owned Arabian Oil Company in the Middle East, is that wherein the Japanese firm directly undertakes a project through the acquisition of real estate or mining rights.

C. Factors Inhibiting Increases in Aid

As Japan passes from the period of reparations and indemnifications into one of more conventional economic aid, there is much interest in its prospects for assuming a larger aid burden commensurate with its position as a major industrial power. On the one hand, Japan may ultimately be able to assume a more active role in economic assistance than any of the European nations, because its national product probably is destined to exceed all but those of the United States and the USSR; and the small share expended on defense is unique among the major powers. On the other hand, Japan has a larger population than any of the European powers except the USSR, and its per capita national output is relatively small. Moreover, in the short run at least, the degree of perseverance that characterized Japan's efforts to normalize its economic relations with former enemies is not likely to be matched in its responses to the pressing capital requirements of the developing countries.

The problems that inhibit increases in the flow of Japanese capital to developing countries are those common to all donors plus a few that are peculiar, at least in some degree, to Japan. Like all the major donor nations, Japan is concerned about the effect of foreign aid on its balance of payments. The balance on current account, in deficit since 1961, swung into surplus in 1965 and 1966 with strong improvement in merchandise trade. Despite a continued large deficit in the capital account, another overall surplus, this time amounting to \$335 million, occurred in the balance of payments for 1966. Nevertheless, Japanese officials and businessmen are wary of long-term capital commitments that might produce or aggravate balance-of-payments difficulties.

The Japanese, in common with others, are also inhibited by conditions in the recipient countries. Japan has been particularly vocal in pointing out the limited absorptive capacity of the developing countries for foreign capital. Thus far, this attitude has led the Japanese to avoid meeting the long-term development requirements of less

developed countries and to focus on aid to specific projects. Over time, however, Japanese participation in aid consortia may foster a greater sense of responsibility for comprehensive development efforts. Recognition of the limitations of less developed countries in planning and staffing economic programs ultimately could be channeled into a greatly expanded Japanese technical and academic assistance effort, but in 1966 Japan was still under attack in the DAC annual meetings for its small contribution in this field.

Another factor inhibiting the flow of Japanese capital to the less developed countries is the unfavorable climate for private investment in these areas. Despite the national fixations of the Japanese on the necessity for export growth and the desirability of diversification of sources of raw materials, the private sector is still essentially cautious about extending its holdings in politically unstable nations. Of probably greater importance has been the high return available on investment at home. Some of the obstacles to overseas investment have been offset by the various government insurance programs,* and Japanese investors have appeared ready to accept greater risks in certain countries, such as Indonesia and Thailand, in which they hope to secure a preeminent position in particular industries.

Although the problems discussed above have been significant impediments to increased capital flows to the developing countries, they do not particularly explain why Japan's contribution to economic development abroad has been proportionately smaller than that of many other industrial nations. The explanation lies in problems that affect Japan more strongly than other nations. Some of the most important of these relate to Japan's comparative stage of economic development.

Among the DAC nations, which include all of the major Western aid donors, Japan has the next to the smallest national income per capita, as can be seen in the following tabulation for 1964:

* See B, 2, above.

<u>Country</u>	<u>US \$</u>
United States	2,700
Sweden	2,020
Canada	1,680
Denmark	1,490
West Germany	1,410
United Kingdom	1,370
France	1,360
Norway	1,310
Belgium	1,300
Netherlands	1,130
Austria	890
Italy	760
Japan	570
Portugal	310

Although Japan's per capita national income stood at \$695 in 1965 and grew rapidly in 1966, the order of rank shown above did not change. Viewed within the context of per capita incomes, the United Nations Conference on Trade and Development (UNCTAD) and DAC aid goal of 1 percent of national income can be described as a sort of regressive tax, and Japanese arguments in the past of inability to meet this standard because of income levels are more convincing than those of most other donors. Indeed, Japanese performance by this criterion alone has been quite respectable. For 1964, computation of the net flow of official and private long-term capital to less developed countries as a share of national income shows Japan ranking with Italy, Canada, and Norway (which cluster around 0.5 percent), significantly ahead of Austria and Denmark, and behind such nations as Belgium, West Germany, the Netherlands, the United Kingdom, and the United States (which approach or slightly exceed 1 percent).

Aid is inhibited also by economic problems arising from the unusually rapid pace of growth in Japan. The flow of long-term capital from the country is affected by rapid growth in at least three unfavorable ways. First, the strong demand for domestic investment in manufacturing that has sustained Japanese growth rates yields high domestic interest rates that tend to make overseas investment less attractive. Second, these high interest charges affect the rates at which funds may be borrowed by government agencies such as the Export-Import Bank and the OECF, and (until a few instances in the last two years) credits extended to the less developed countries by these agencies have had to be offered at terms no more attractive than those of the IBRD.* Finally, the remarkably

* Although the OECF now loans at lower rates, all bilateral Japanese loans to less developed countries are tied to procurement in Japan. Thus Japan is not strictly competitive with the IBRD in loan assistance.

strong demand for investment in the private sector, of which the tight domestic capital market is symptomatic, has meant inadequate investment in the public sector. This last consideration suggests that budget appropriations for Japanese aid will have to compete against increasingly strong demands for Japanese government spending on housing and public works at home.

For a number of reasons, the Japanese find it hard to secure public and parliamentary approval of significant enlargement of their official aid effort. Although the public is aware of the importance of foreign trade to Japan's industrial growth, it has only the most tentative impression of the recent emergence of the national economy into the front rank of major economic powers and generally has no conception of how Japan might contribute to the needs of developing countries. Public confusion on Japan's role as a donor country is compounded by the lack of cooperation or constructive suggestions from the Japan Socialist Party. Areas of bipartisan agreement on foreign aid policy are notably absent in Japanese politics, and the fact that the Socialists have had no experience in administering Japanese aid only aggravates this problem. In late June 1966 the Socialists embarrassed the Sato government internationally by blocking the passage in regular Diet session of an appropriation for the Asian Development Bank. At the same time the Socialists advanced a rather naive "long-range policy" on Japanese aid that called for, among other things, the creation of a "Peace and Prosperity Force" from personnel of the Japan Self-Defense Forces to improve relations with other countries. Besides the fact that the Japan Overseas Cooperation Volunteers are already performing the function of such an organization, this proposal raises the question of how Southeast Asians might react to the presence of an organization with a Japanese military background.

The most pressing problem is the need for better administrative organization and coordination between official agencies. The principal agencies concerned with foreign aid and investment and their responsibilities are as follows:

Ministry of Foreign Affairs

Assumes leading role in generating aid proposals; supervises Overseas Technical Cooperation Agency;

Ministry of Finance

Occupies pivotal budgetary position; wields important discretionary power in extensions of credits and allocation of some grants; supervises Export-Import Bank and exercises strong influence on operation of the Overseas Economic Cooperation Fund;

Ministry of International Trade and Industry (MITI)

Presses commercial interests in formulation of official aid policies; supervises Asian Economic Research Bureau;

Economic Planning Agency

Participates in formulation of long-term aid goals; officially responsible for supervision of OECF.

There are rivalries among these organizations that reflect both the particular perspectives of the various organizations and the fact that ministers are often chosen so as to balance the Liberal Democratic factions in the Cabinet. Thus the attributes cumulatively described as "commercialism" in Japanese aid activities are readily associable with MITI's primary mission of promoting exports or the caution of the Finance Ministry in assessing credit risks. The Foreign Ministry, which characteristically takes the most positive stance toward increased and more liberal aid, has found itself embarrassingly ahead of the rest of the Japanese government on many occasions. This gap has been partially closed by the growing emphasis of Prime Minister Sato on a greater Japanese role in regional economic affairs in Asia, by the repeated incantations of former Finance Minister Fukuda that Japan would meet the UNCTAD aid goal of 1 percent of national income,* and by the relatively

* It is worth noting that the achievement of this much-discussed goal was not tied to any particular time until the Ministry of Foreign Affairs picked FY 1968 as target year in a draft three-year economic cooperation program completed in March 1966. The program apparently has not yet received the blessing of the Ministry of Finance. At the annual DAC review of Japan's aid program in June 1966, Foreign Ministry officials were still unwilling to specify a target year.

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imaginative suggestions for assistance in agriculture and marketing of primary products to less developed countries that emanated from MITI under the leadership of the politically ambitious Takeo Miki. One of the most encouraging features of the Southeast Asian Ministerial Conference on Development held in Tokyo in early April 1966 was the direct involvement of the whole Japanese Cabinet in discussions of regional economic cooperation. Participation in such an international conference created pressure for more creative thinking on economic development, and, exposed to public view, the various Cabinet members discussed assistance in joint development activities more daring than they would otherwise have been inclined to support.

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II. JAPANESE AID TO FREE ASIA

A. The Region's Share of Japanese Aid and Investment Activities

Asia has been the principal beneficiary of Japanese aid activities.* Although basic data are often inconsistent, the following crude estimates may be made of annual Japanese official and private financial assistance to the Free Asian countries:

<u>Year</u>	<u>Million US \$</u>
1960	125
1961	165
1962	145
1963	175
1964	200
1965	265

A comparison of these figures with the data in Table 1 shows that Free Asia received about 60 percent of all Japanese assistance to the less developed nations from 1960 through 1965. Although data for earlier periods are inadequate to make specific, reliable comparisons, the Free Asian share of Japanese official and private assistance was probably significantly higher than two-thirds in most years prior to 1960.

Reparations and indemnifications have been the most important element in official grant aid, accounting for about 95 percent of the total to date. All of the disbursements under these reparations programs were made to Asian countries, as well as \$40.1 million in official bilateral grants (see Table 2). Official grant aid has gone almost exclusively to Asia, and this trend is likely to continue for the foreseeable future. Although the regular reparations programs in Burma and South Vietnam have been completed, such current commitments as reparations to the Philippines, continued grant aid to Burma and Indonesia, and grants under the normalization treaty with South Korea will probably account for well over half of the disbursements of bilateral grant aid over the next few years.

* For major details of commitments of official grant and credit aid to Asian countries, see Table 3.

Table 2

Japan: Grant Aid to Free Asian Countries
1950-65

Thousand US \$				
	Total Bilateral Grant Aid to all Countries	To Free Asian Countries		Total Grant Aid a/
		Reparations and Indemnifications	Other Grants	
1950-59 b/	395,800	395,800		395,800
1960	66,900	64,300	2,100	66,500
1961	67,800	65,100	1,700	66,800
1962	74,600	69,500 c/	4,100	73,600
1963	76,700	64,900 c/	10,800	75,700
1964	68,700	60,500 c/	6,400	67,000
1965	82,200	65,600 c/	15,000	80,600
Total	832,700	785,700	40,100	826,000

a. Because of rounding, components may not add to the total shown.

b. Including settlement of an Indonesian trade deficit of \$176.9 million and payments for the Thai Special Yen Account.

c. Including disbursements under the Thai Special Yen Account for 1962-65.

Bilateral grants other than those related to reparations, Korean normalization, and the special grant program for Burma have been disbursed primarily for technical assistance. In this category, Asia has again been the principal beneficiary. Thus, of a total of some \$20 million in grants for technical assistance from 1962 through 1965, almost three-fourths went to Free Asia. In addition to financing the overseas activities of Japanese technicians, these grants have funded the Japanese share of establishing technical training centers in a number of Asian countries.

The share of Southeast Asia in Japanese official loans is more difficult to gauge because of recurring changes in classification of data. In annual presentations to DAC, the Japanese government has cited figures indicating that since 1963 well over three-fourths of the

annual net disbursements of all official loans to less developed countries have gone to Free Asia.* By far the largest part of these disbursements has been channeled through the Export-Import Bank of Japan. After adjusting available regional data of the Export-Import Bank for FY 1963 and 1964 to exclude credits to developed countries, the Free Asian share of credit commitments to the less developed countries in those years amounts to over 50 percent. This figure may misstate the region's share of long-term assistance, for it includes credits for less than five years. Despite the inadequacy of such an indicator, it is clear that credit commitments by the Export-Import Bank to Asian countries are both numerous and of major importance. Indeed, by the end of FY 1964, "special yen" agreements** with India and Pakistan had accounted for 10 percent of all credit commitments since the founding of the Export-Import Bank in 1950.*** Finally, using all Export-Import Bank loans outstanding to the less developed areas of the world at the end of FY 1964 as another crude index of this organization's participation in Japan's long-term credit assistance, loans to Free Asia account for about half the total.

Since 1961 the OECF has also participated in Japan's credit assistance, and the activities of this institution again indicate the primary position of Free Asia in official Japanese aid. Although only about half of the \$57.4 million in total commitments of the OECF as of the end of January 1966 was accounted for by Free Asian countries, the OECF was responsible for disbursing funds over 10 years to South Korea under a line of credit for \$200 million related to the normalization treaty and to Nationalist China over five years under a portion of a \$150 million line of credit also agreed to in 1965. The Director of the OECF Loan Department indicated in early 1966 that, despite a capital subscription of \$20.8 million in the national budget for FY 1966, he expected half of the total funds of \$64 million available to the OECF to be required to meet 1966 disbursements under the Korean and Nationalist Chinese commitments. Increasing pressure from other donors and from the less developed countries themselves for more liberal Japanese credit terms

* In 1961 and 1962 the Asian share of net official credit disbursements stood at an unusually low 40 percent. This was the result of heavy disbursements on a steel mill in Brazil and lags in implementation of "special yen" credits to India and Pakistan.

** See I, B, above.

*** Between the end of FY 1964 and February 1967, another \$300 million of major credits were extended to India, Pakistan, Nationalist China, and Malaysia alone by the Export-Import Bank.

may lead to further expansion of OECF activities; but, partially because of a sense of familiarity with the region, Japanese business interests probably will tend to focus these activities on Southeast Asia in general and Indonesia in particular.*

Although regional data on long-term private capital flows** from Japan to the less developed countries are both scarce and inconsistent, available information indicates that Free Asia received about a third of such capital from 1962 through 1965. Over this period the annual flows to the region ranged from less than one-third to an exceptional one-half of total Japanese investment and long-term private credits to the less developed countries. Of the two major categories, Free Asia received a greater net share of guaranteed private export credits than of net direct investment. Indeed, despite a considerable number of individual investments in a wide variety of enterprises throughout Asia, the stock of Japanese investment in the region at the end of 1965 amounted to only about 28 percent of total Japanese investment in less developed countries. In no small measure, this pattern is a reflection of the unreceptive attitude toward foreign private investment on the part of several governments of the region.

B. The Japanese Role in National Development Activities

All of the countries of Free Asia have been recipients of Japanese long-term capital. In some of these countries the relative importance of this assistance to economic development has been especially noteworthy. Thus \$200 million in reparations have been by far the most important postwar source of official foreign grants for Burma, and the successor program of \$140 million in grants occupies the same position among Burma's present resources for financing development. In Indonesia and the Philippines, Japanese reparations have been second only to US aid as a source of grant disbursements, and unpaid balances under the reparations program in the Philippines are

* In Indonesia, OECF credits have helped provide capital for production-sharing investments in petroleum, nickel ore, and forestry development projects.

** Data that follow are for private direct (equity) investment and government-guaranteed credits for more than five years.

currently the principal grant commitments to that nation.* The grants and loans to be provided to South Korea under the normalization treaty will make Japan the second-ranking donor of aid to that nation. Through its "special yen" credits, Japan, as a member of aid consortia, has also been a significant participant in the economic development of India and Pakistan. A credit for \$150 million to be disbursed over five years to Nationalist China will bring the annual amount of Japanese assistance to that country almost to the level of the remaining US economic assistance. Japan has also become a major contributor of official foreign aid for the current Malaysian five-year development program through the extension of a \$50 million credit in late November 1966. Conclusion of an agreement on a similar \$60 million credit to Thailand, which is still under discussion, would greatly enhance the Japanese role in that nation's development activities.

1. Official Aid Activities

The quality or yield of official Japanese assistance in the countries of Free Asia is difficult to describe in other than general terms. Japan, like other donor countries, has encountered difficulties in administering project aid. A recurrent theme in criticisms of Japanese aid has been the failure to consider the requirements of the recipient. There are reasons to suspect that this criticism, although valid, may lose some of its applicability as the reparations payments draw to a close. The Japanese have felt that reparations payments should be completed as expeditiously as possible, and the nature and mechanics of these transactions are not conducive to strong Japanese suggestions on end use. Officials of the Philippine government have done some soul-searching in recent times, and a representative judgment is that only about 60 percent of the reparations disbursed in that country were effectively used for national economic development. Both ex-President Macapagal and President Marcos have expressed concern over waste by Philippine recipients

* The remaining reparations commitments to Indonesia are not as large or accessible as the \$300 million or more as yet undisbursed to the Philippines. Of \$42.9 million still due Indonesia as of December 1966, \$39.7 million secures loans upon which Indonesia will probably be unable to make further payments.

of this aid and have urged that more productive use should be made of this important source of foreign capital. *

More effective coordination of Japanese aid activities with national development programs of the recipients might be achieved through increased involvement in aid consortia. The Japanese have been regarded as cooperative participants in the consortia for India and Pakistan. To avert the disorder that might attend a loosely administered normalization program in Korea, the United States sought to have Japan participate in a Consultative Group for that country, and the Japanese joined the group for its first formal meeting in December 1966. The activities of consortia provide the Japanese Ministry of Foreign Affairs with justification in arguing to the Ministry of Finance that Japan is being asked to give its "fair share" in assistance to the recipients. Thus far, however, this has done little to overcome the necessity that the Foreign Ministry justify aid programs on the basis of potential trade gains.

Official Japanese reparations and aid have been disbursed for a wide variety of end purposes, as can be seen in Table 3 (which shows some of the forms of official Japanese aid to Free Asia). Principal projects have included major public works (such as power plants, an irrigation scheme, bridges, and water supply systems -- see Figure 2) and contributions to industrial development through the construction of numerous plants in both light and heavy industries throughout the region. Within the recipient countries, these projects frequently have been notable for either scale or type. Thus the Balu Chaung hydroelectric plant in Burma and the Da Nhim hydroelectric plant in South Vietnam** are the largest such installations and the principal elements of installed capacity in these countries. The Brantas River development project in Indonesia has been racked with difficulties and, at best, can only be completed well past the target date of 1969. This project, which was to include the nation's second or third largest hydroelectric installation, was intended to supply the power necessary to regional industrial development in eastern Java and major irrigation and flood control facilities for the nation's leading agricultural area.

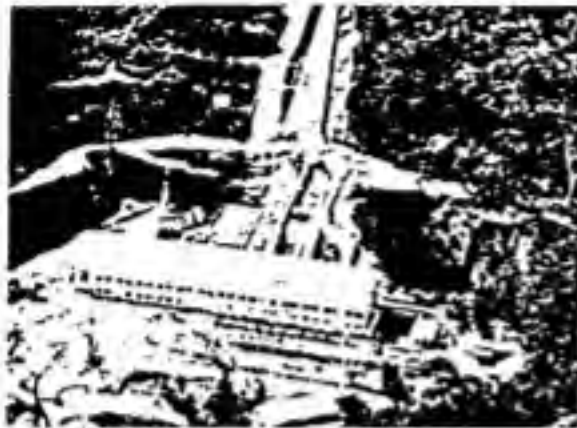
* To secure more effective use of these funds, Marcos has urged legislation to channel all remaining reparations to the public sector.

** This installation has not been in full use since May 1965 as a result of Viet Cong sabotage to the power lines.

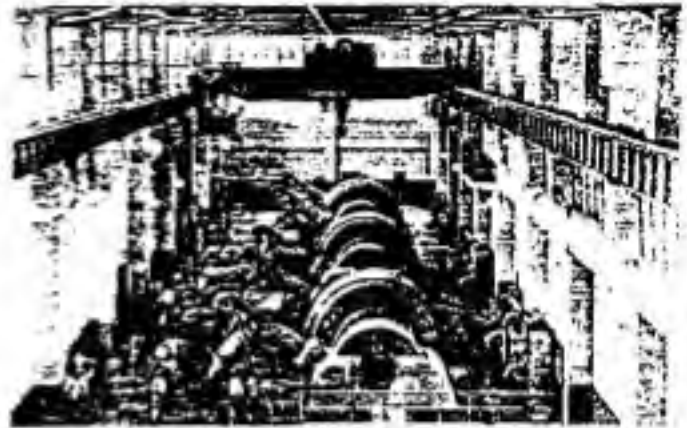
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FIGURE 2

JAPAN: SELECTED AID PROJECTS IN FREE ASIA



BURMA: EXTERIOR VIEW OF THE
BALU CHAUNG POWER STATION



BURMA: INTERIOR VIEW OF THE BALU CHAUNG
POWERHOUSE



SOUTH VIETNAM: DA NHIM FALLS HYDRO-
ELECTRIC DAM



INDONESIA: MUST RIVER BRIDGE

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Table 1

Japan: Some Uses of Reparations and Official Aid to Free Asia
as of 31 March 1966

Recipient	Principal Assistance		Uses of Assistance Disbursed		Principal Nonproject Assistance
	Committed	Disbursed	Principal Projects		
Burma	(1) 100 (B) \$/	200	Hydroelectric plants; motor vehicles assembly plants; electric appliances assembly plants; other plants		Machinery; transport equipment; steel products; ceramic ware; textiles; fertilizer
Indonesia	(2) 140 (C)	8.3	Various assembly plants		Transport equipment
	253 (R) \$/	155.6	Major river development project (power and irrigation); paper plants; cotton-spinning plant; other plants		Cargo ships; motor vehicles; railroad equipment; machinery; chemical products; pulp and textiles
Philippines	550 (R)	204.7	3 cement plants; various assembly and manufacturing plants		18 cargo ships; construction materials and heavy equipment; railroad equipment; industrial machinery; consumer goods
South Vietnam	39 (B)	39.0	Hydroelectric plant; small wood-products plants		Diesel engines
Laos	2.8 (G)	2.8	Water supply and sewer systems in Vientiane; power plants		
Cambodia	4.2 (G)	4.2	Establishment of three training centers; Ton Le Sap bridge		Construction materials for water supply and sewer systems in Phnom Penh
India	330 (Sp Y) \$/	210 (estimated)	Power projects; alloy steel plants; fertilizer plants; other plants		Cargo vessels; railroad equipment; machinery; spare parts

Pakistan	105 (Sp Y) d/	AO (estimated)	Steel mill; textile mills; paper plant; alloy steel plant; other plants	(Planned use: fertilizer, textiles, trucks, and spare parts)
Ceylon	5 (C)			
Nationalist China	150 (C)	N.A.	(Planned use: multipurpose dam; harbor development; bridge; power development; industrial plants)	
South Korea	(1) 300 (C) g/ (2) 200 (C) g/	4.5		(First-year payment on \$45 million trade deficit)

a. (R) = reparations
(Sp Y) = "special yen" credit
(G) = other grants
(C) = other credits

b. In addition, Indonesia received \$177 million in grant aid under reparations in the form of a trade deficit cancellation.

c. An additional \$42.5 million credit and a deferment of \$2.5 million in existing credits were agreed to on 16 December 1966.

d. Two additional \$30 million credits were extended on 6 May 1966 and 24 February 1967, bringing the total commitment to \$165 million.

e. The first-year program under the normalization agreement called for disbursements of \$48 million in grants and \$45 million in credits, and a second-year program negotiated in February 1967 provides for \$50 million and \$36 million, respectively, for these forms of aid. In addition to official assistance, Japan has set a relatively ambiguous guideline of \$300 million in private credits to be extended under the normalization agreement.

In India the projects in which Japan has participated under the "special yen" credits have included the construction of two particularly large fertilizer plants and the nation's leading plant for making alloy and special steels. A 150,000-ton steel ingot plant that is, in essence, Pakistan's modern steel industry is also a Japanese-aided project.* Two of the eight operating cement plants in the Philippines, accounting for over 20 percent of annual production, were equipped under the reparations program, and a third plant had not yet received all of its reparations-financed equipment in late July 1966.

Nonproject assistance by the Japanese government to the less developed countries has also been extensive and has taken the forms of both capital equipment and consumer goods. The reparations agreements covered such aid, and subsequent grants have also provided for various types of nonproject uses. Those suppliers' credits and government-to-government credits of the Export-Import Bank that until recently comprised Japan's only loan assistance program to the less developed countries were frequently nonproject aid. Although future "special yen" credits to India and Pakistan and loans under the normalization agreement with South Korea probably will be oriented primarily to specific development projects, nonproject assistance will continue to be an important element of the capital flow from Japan to the other Free Asian countries. Attempts to draw a sharp line between project and nonproject aid or to assign aggregate values to either category may cause unnecessary confusion. In the case of Japan, the major role played by transportation equipment and industrial machinery in nonproject aid increases this risk. Thus it is somewhat arbitrary to describe the supply of 15 large oceangoing freighters and 3 smaller interisland ships to the Philippines as "nonproject" aid when it might as easily be regarded as a major component of an infrastructure "project" for the Philippine fleet. (see Figure 3). A similar problem would arise in connection with the first normalization loan by the OECF to Korea, which provided \$11 million for purchases of rolling stock. As the Japanese aid program moves out of the era of reparations, Japan (both as a bilateral donor and a member of consortia) will become increasingly concerned with coordinating its nonproject aid with national development goals abroad. Foreign pressures on the Japanese government to restrict supplies of

* Opened on 1 February 1967, this plant will be increased to a capacity of 250,000 metric tons over the next few years. (Ton-nages are given in metric tons.)

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FIGURE 3

JAPAN: "NONPROJECT" AID TO THE PHILIPPINES



THE VESSEL MARIA ROSELLO

consumer goods in favor of nonproject aid in the forms of industrial and transportation machinery and agricultural equipment will tend to increase. At the same time, the numerous difficulties encountered by the Japanese textile industry in the United States and other markets will mean a continuing effort on the part of that industry to sustain sales through participation in official aid programs, and it is likely that the Japanese government will continue to offer textiles in such emergency credit assistance as that extended to Ceylon and Indonesia in 1965 and 1966.

Extensive technical assistance has also been provided by Japan to the developing countries of Free Asia. The most important element of the Japanese technical assistance "program"* is the training of students and technicians in Japan (see Figure 4). Country totals for this activity, shown in Table 4, reflect trainees both under programs for which Japan bore full expenses and under those for which it bore only part of the costs.**

* For a description of the forms that Japan's technical assistance takes, see p. 14, above.

** The latter category includes the US-Japan Joint Third Country Training Program, under which some 2,200 personnel were trained before it phased out beginning in 1964, and the various United Nations programs.

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FIGURE 4

TRAINING IN JAPAN OF STUDENTS AND TECHNICIANS FROM FREE ASIAN COUNTRIES



INSTRUCTION IN TEXTILE PRINTING TO AN INDONESIAN TECHNICIAN IN JAPAN



INSTRUCTION TO A BURMESE TECHNICIAN AT THE JAPANESE ATOMIC ENERGY RESEARCH INSTITUTE

Table 4

Japan: Academic and Technical Training of Free Asians
Total for 1954-66 a/

Country	Number of Trainees	Country	Number of Trainees
Nationalist China	1,055	Pakistan	332
Thailand	965	Cambodia	228
Indonesia	926	Ceylon	220
India	641	Vietnam	207
Philippines	542	Other Free Asian	520 b/
South Korea	398	All other	1,466 b/
		Total World	7,500 b/

a. Data as of October 1966.

b. Estimated.

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Although it may be useful to distinguish between the categories of "academic students" and "technical trainees" for some purposes, the thrust of the Japanese training effort can best be visualized as an effort to provide advanced or specialized training to both experienced nondegree and degree students or trainees. On the basis of fragmentary data, it appears that about 25 to 30 percent of the technical and academic trainees from Free Asia probably have received instruction in agriculture and fishing, with distinctly smaller shares being trained for a variety of other fields. As can be seen from Table 5, which shows the number of Free Asian students and trainees in Japan in 1965, agriculture currently places second to engineering among academic disciplines and second to the field of public utilities in technical training.

Table 5

Fields of Instruction of Free Asian Academic Students
and Technical Trainees in Japan
1965

Field	Number of Students	Field	Number of Technical Trainees
Engineering	198	Power, transport, and communications	171
Agriculture	55	Agriculture	163
Medicine	49	Industry, mining, and handicrafts	159
Social sciences	46	Public administration	48
Natural sciences	36	Health services	45
Other	47	Other	112

In addition to training programs at home, Japan sponsors considerable technical assistance abroad (see Figure 5). Since

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FIGURE 5

JAPAN: OVERSEAS TECHNICAL ASSISTANCE TO FREE ASIAN COUNTRIES



INSTRUCTION ON THE OPERATION OF A FISH DETECTOR IN THE PHILIPPINES



INSTRUCTION ON THE OPERATION OF A THRESHING MACHINE AT THE AGRICULTURAL TRAINING CENTER IN PAKISTAN

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1954 the Japanese government has dispatched over 800 experts to Free Asian countries.* In 1965 the 425 experts and technicians in Free Asia being financed by the Japanese government were distributed by fields as follows:

<u>Field</u>	<u>Experts and Technicians</u>	<u>Field</u>	<u>Experts and Technicians</u>
Agriculture	116	Education	33
Industry, mining, and handicrafts	105	Health services	30
Economic planning and surveys	85	Other services	1
Power, transport, and communications	55		

Japan also has helped a number of Free Asian countries establish training centers. These have included eight agricultural demonstration farms in India, agricultural training centers in Cambodia and Pakistan, a fisheries center in Ceylon, a marine-products center in India, small-scale industry centers in Afghanistan and India, telecommunications centers in Pakistan and Thailand, medical centers in Cambodia and Thailand, and a road construction center in Thailand. Related to this form of assistance are current plans of the Ministry of International Trade and Industry to assist in the construction and operation of model industrial plants abroad. Proposals for FY 1967 include a rice-bran oil plant for Cambodia and an agricultural implements plant for Laos. Finally, Japanese technical assistance has included many preinvestment and feasibility studies on mineral resources, infrastructure projects, and industrial development.

2. Private Investment Activities

Consideration of the role of Japan's private sector in the national development activities of Free Asian countries is hampered by inadequate data and the fragmentary nature of reports on specific transactions. Data

* Although pertinent figures are extremely sparse and outdated, it is possible that the private sector has sent five times as many technicians to Free Asia in connection with exports of machinery and equipment and private investment in the region.

recently published by the Ministry of Finance show the following percentage distribution by productive activities of a total Japanese investment flow of \$177.8 million to Free Asia from FY 1951 through FY 1965:

<u>Productive Activities</u>	<u>Percent</u>	<u>Productive Activities</u>	<u>Percent</u>
Agriculture, forestry, and fisheries	5	Steel and other metals	6
Mining	44	General machinery	4
Food processing	11	Electrical machinery	3
Textiles	11	Other	16
		Total	<u>100</u>

The Japanese apparently have been unable or reluctant to publish compilations showing the related information on the stock of their investment by projects or countries. Some sense of the kinds of projects in which the Japanese have participated can be derived from the list (which is less than exhaustive) of lines of postwar investment in Figure 6. Data on the stock of investment by countries for 1960 have been extracted for Table 6 from one of the relatively rare Japanese releases of information on this topic. Read in conjunction with Table 7, * which shows the net flow of Japanese direct investment to Free Asia for 1963-65, these data provide a number of reliable general impressions.

* Note that the data are in no way additive because of the gap from 1960 through 1962. Some flow data are available for this period but, because of various inadequacies, are not shown here.

FIGURE 6
JAPAN: SOME LINES OF PRIVATE INVESTMENT IN FREE ASIA
1945-66

COUNTRY*	PRINCIPAL POSTWAR LINES OF JAPANESE PRIVATE INVESTMENT
THAILAND	TIN AND TUNGSTEN MINES; AUTOMOBILE, TRUCK, AND MOTORCYCLE ASSEMBLY PLANTS; GALVANIZED IRON SHEETS; RADIO EQUIPMENT; MANUFACTURE OF APPAREL; FISHING NETS; SUGAR REFINING
INDONESIA	PETROLEUM; NICKEL ORE MINES; TIMBER EXTRACTION
SINGAPORE	SHIPYARD; STEEL MILL; CEMENT MILL; STEEL TUBES; ELECTRIC WIRES AND CABLE; ELECTRIC APPLIANCES; POLYVINYLCHLORIDE PIPES; PLYWOOD; PAPER BAGS; MATCHES; APPAREL
MALAYSIA	IRON ORE MINES; IRON AND STEEL MILLING; TIN SMELTER; CEMENT MILLS; TIMBER AND WOOD PRODUCTS; TEXTILES AND WEARING APPAREL; FOOD PROCESSING; FISHERIES
PHILIPPINES	IRON ORE MINES; COPPER MINES; TIMBER EXTRACTION
INDIA	IRON ORE MINES; SPECIAL STEEL WIRES AND WIRE ROPE; ELECTRIC WIRES AND CABLE; POLYVINYLCHLORIDE PRODUCTS; BICYCLE TIRES
HONG KONG	TEXTILES AND APPAREL; SHIP SALVAGE; STEEL PRODUCTS
NATIONALIST CHINA	AGRICULTURAL MACHINERY; WIRE ROPE; FLUORESCENT LAMPS; CHEMICAL AND SYNTHETIC TEXTILE PROCESSING

* LISTED IN PROBABLE ORDER OF RANK OF THE VALUE OF STOCK OF JAPANESE INVESTMENT.

Table 6

Stock of Japanese Private Direct Investment in Free Asia
as of March 1960

	Thousand US \$
Philippines	8,282
India (including Goa) <u>a/</u>	6,314
Malaysia (including Singapore)	5,937
Thailand	3,021
Indonesia	1,712
Nationalist China <u>b/</u>	1,412
Pakistan	635
Hong Kong	209
Other	3,080
Total Free Asia	<u>30,602</u>
Total overseas investment	185,801

a. Goa accounted for \$4.1 million of this total.

b. In early 1967 the Nationalist Chinese Minister of Economic Affairs stated that Japanese investment in Nationalist China over the last 12 years (1955-66) had totaled \$11 million.

Table 7

Net Flow of Japanese Private Direct Investment to Free Asia a/
Total for 1963-65

	Sector			Thousand US \$
	Manufacturing	Minerals	Other	Total Value of Investment Flow
Thailand	27,995	504	2,562	31,161
Indonesia	0	16,973	0	16,973 <u>b/</u>
Malaysia (including Singapore)	8,928	-127	973	9,774
Hong Kong	4,805	20	1,302	6,127
Nationalist China	3,940	-19	102	4,023 <u>c/</u>
India	1,382	-122	241	1,501
Pakistan	187	0	1,179	1,366
Philippines	0	1,148	75	1,223
Other	348	197	24	569
Total	<u>47,585</u>	<u>18,574</u>	<u>6,558</u>	<u>72,717</u>

a. Including reinvested earnings for 1965 only.

b. Of which 39.3 million was invested in petroleum development.

c. See the second footnote in Table 6.

Thailand (and especially its manufacturing sector) is clearly the major beneficiary of Japanese private investment, with the surge in Japanese activities in this country beginning after 1960. Both before and since 1960, there has been significant Japanese investment in Malaysia and Singapore.* The data also reflect considerable Japanese investment in Indonesia, which indicates that the production-sharing approach to investment is sufficiently attractive in that case to counterbalance myriad problems of political and economic instability. India, where private initiatives have been stymied by extensive government controls and participation in industry, has received little Japanese private investment; and this point becomes even more apparent when some \$4.1 million of investment in Goa, then a Portuguese colony, is deducted from the 1960 data.** Finally, the two tables point up a decline in the share of the Philippines in Japanese private investment that results from two unrelated factors. First, Japanese investment in the minerals sector and in forestry took the form of production sharing, and initial outflows of capital from Japan were later offset by inflows of resources from the Philippines that thereby represented Japanese disinvestment. Second, Japanese investment in any joint ventures has been held up by the reluctance of the Philippine Congress to ratify the Treaty of Amity, Commerce and Navigation signed in December 1960 and ratified shortly thereafter by the Japanese Diet.

C. The Japanese Role in Regional Development Activities

During the 1950's, Japan slowly reestablished its presence as a significant participant in the economic affairs of Free Asia. Increasing bilateral aid, trade, and private investment were important factors in this recovery. Somewhat greater difficulty was experienced by the Japanese in trying to find their place in regional efforts to develop the nations of Free Asia. This difficulty resulted from the lack of a sense of community or common purpose among the other Free Asian nations.

* Over five years ending in mid-1966, Japanese investment in joint industrial ventures in Singapore reportedly amounted to \$23.5 million (which was distributed among 19 companies), and \$18.3 million more was expected to be invested by 1968. Japanese investment in Malaysia, including a few overseas branches of Japanese firms, was more reliably assessed by October 1966 at \$10.1 million spread among 27 enterprises.

** In January 1966 a Japanese newspaper reported the stock of Japanese investment in India to be \$8.4 million, spread over some 200 different industrial ventures. All but some 25 of these ventures took the form of technical collaboration (or licensing).

the necessary Japanese preoccupation with reconstruction and growth, and the reluctance of the Japanese to be accused of seeking a new version of the Greater East Asia Co-Prosperity Sphere.

The postwar involvement of Japan in regional development activities can be traced back to its acceptance as a full member of the Economic Commission for Asia and the Far East (ECAFE) in April 1953 or of the Colombo Plan in October 1954, (see Figure 1), but the real thrust of Japanese efforts to play a positive role in regional development activities came in 1957 with the "Asian-centered diplomacy" of Prime Minister Kishi. Kishi toured the countries of Free Asia in 1957 and carried the messages of Japan's peaceful interest in Asian economic development and the necessity for closer regional cooperation. The Kishi government concluded reparations agreements with Indonesia and Vietnam, liberalized the credit functions of the Export-Import Bank, initiated the "special yen" credits to India, and took measures to stimulate private investment in less developed countries. It also offered a few cogent proposals for regional development. One of the most interesting of these was the suggestion that the advanced nations, particularly the United States and Japan, should contribute capital for a Southeast Asia Development Fund from which Free Asian nations might borrow. Among a variety of other Japanese assistance efforts in Free Asia under the Kishi government, the dispatch in 1959 of three Japanese missions to survey the Mekong River stands out as one of the earlier activities of the Mekong Commission* and one of the first tangible Japanese contributions to what can legitimately be called a regional project.

There was no real diminution in Japanese economic activities in Free Asia under the Ikeda government, which came to power in mid-1960. This new administration, however, was not as convinced of the ultimate primacy of Free Asia in Japanese trade opportunities and was more concerned with problems of domestic economic growth. Nevertheless, Japan took an increasingly active part in meetings of the ECAFE under the Ikeda government.

An important element in Japan's confident emergence in recent times as the economic leader of Free Asia is the growing national cognizance of advanced industrial status. With Japanese income

* The Mekong Commission came into being in 1957.

per capita less than that of Italy or Venezuela and frequent uncertainty among Western economists as to whether Japan should be called a developed nation, many Japanese only began to appreciate the nation's new economic status with its attainment of regular membership in the OECD and its elevation to Article VIII status* in the IMF in April 1964. Reinforcing the sense of coming of age in 1964 were repeated foreign comments on the remarkable progress of reconstruction and industrial growth in Japan and the country's successful job in hosting the Olympics. Stimulated by the plea of the UNCTAD for donors to increase aid as a share of national income to 1 percent, the Japanese were reviewing their own aid programs when President Johnson made his 7 April 1965 speech calling for Asian initiatives to effectively employ \$1 billion in regional economic development in Southeast Asia. For many Japanese (especially those in the Foreign Ministry), the President's speech was the long-awaited opening for positive Japanese leadership in regional affairs and an opportunity to cooperate more directly with the United States in the development of Free Asia.

Since early 1965 the Sato administration has shown considerable interest in increasing Japan's role in regional economic projects as part of the effort to expand its development assistance. One of the most impressive aspects of this new interest is the fact that Japan's subscription of \$200 million to the capital of the Asian Development Bank (ADB),** an organization conceived by the ECAFE, was as large as that of the United States. Indeed, the Japanese have even informally suggested to the United States the multilateral creation of a special fund for regional agricultural development to be administered by the ADB. As originally proposed in July 1965 by Takeo Miki, Minister of International Trade and Industry, this agricultural fund was to amount to some \$200 million outside of the \$1 billion of basic ADB capital and was to be used to advance low-interest loans for individual agricultural projects and community development. At various

* Article VIII of the Fund Agreement of the International Monetary Fund (IMF) requires the country concerned to refrain from imposing restrictions on current payments and transfers of foreign exchange without prior approval. Attainment of this status by Japan signified a greater responsibility for the operation of the international monetary system.

** The Asian Development Bank, which opened formally on 19 December 1966 in Manila, has a total capital of \$1 billion subscribed by the nations of Free Asia and the advanced countries. Half of this amount is to be paid into the bank over a period of five years. In late September 1966, Japan made its first annual payment of \$20 million.

points in the discussion of the Miki plan, the Japanese Foreign Ministry has spoken in terms of Japan subscribing \$100 million to such a fund. This concept is now under intensive study by the Japanese government, and there is a good chance that a modified version of the Miki plan will be made public in 1967.

Japan's initiatives in the Mekong Committee also represent increased participation in ECAFE-sponsored programs for regional development. In March 1966, Japan agreed to provide a grant of \$4 million to help meet a total cost of \$22.8 million for the Nam Ngum hydroelectric project on a Mekong tributary in Laos. More recently, the Japanese Foreign Ministry, with unofficial encouragement from the United States, has taken the lead in trying to organize financial support for construction of a multipurpose dam under the Mekong Committee on the Prek Thnot River in Cambodia. In January 1967 the Japanese government notified the Mekong Committee that it was prepared to provide up to \$11 million, of which \$5 million would be in grants, toward the cost of the dam if the other donor countries could come up with the remaining \$11 million.

Of potentially greater importance to Free Asian development than Japan's participation in the projects of multilateral agencies is its new-found confidence in openly assuming the leader's role in attacking regional economic problems. The clearest (and, indeed, the first) manifestation of this new confidence was the Southeast Asian Ministerial Conference on regional economic development convened by Japan in Tokyo in early April 1966 (see Figure 7). This two-day conference was attended by

FIGURE 7



JAPAN: PRIME MINISTER SATO ADDRESSING THE SOUTH-EAST ASIAN MINISTERIAL CONFERENCE IN TOKYO IN APRIL 1966

economic ministers from Japan, the Philippines, Malaysia, Singapore, Laos, South Vietnam, and Thailand and observers from Indonesia and Cambodia, and covered such basic issues as capital formation, technological development, access to export markets, agricultural development, industrialization, and improvement of public works and services. Although such a brief gathering could only scratch the surface of problems in these areas, the Tokyo Ministerial Conference had a number of merits beyond its contribution to Japan's growing international confidence. First, it did provide a purely Asian setting in which representatives of Southeast Asian countries with divergent political attitudes could discuss their problems. More importantly, it dramatized to the Japanese people and to elements of the Japanese bureaucracy not usually concerned with foreign relations the new responsibility for regional economic leadership incumbent upon Japan as an advanced industrial nation. The conference also thrust upon the more conservative and parochial Japanese ministries the new role of seeking areas in which they could assist in regional development, and this challenge was enthusiastically met by proposals for a variety of regional cooperation schemes. Finally, the Tokyo Conference initiated a new round of Japanese offers of credit assistance, with \$60 million proposed for Thailand, \$50 million for Malaysia, and \$7 million for Cambodia.

In addition to giving rise to plans for a similar meeting in Manila in 1967, the Tokyo Ministerial Conference in April provided for another conference in Tokyo in November 1966. Rescheduled for 6-7 December 1966, this second Tokyo conference was to be concerned exclusively with Southeast Asian agricultural development. The December meeting was attended by approximately the same group of countries that went to the April ministerial conference* and by observers from various international organizations. This meeting strongly endorsed the idea of a regional agricultural development fund, thereby clearing the way for more active Japanese involvement in this field. It also called for feasibility studies for fishery training and research centers in Southeast Asia. By early 1967 the Japanese government was well under way with plans to establish four such centers, beginning with one in Bangkok to be in operation in 1967.

* The April meeting represented no small diplomatic triumph in securing Indonesian and Cambodian attendance in observer status. In December, Indonesia and Cambodia sent regular delegations. Heroic Japanese efforts to secure Burmese participation in December were unsuccessful.

III. JAPANESE TRADE WITH FREE ASIA

A. Magnitude and Growth

Japan's exports to Free Asia in 1965 were valued at about \$2.2 billion and imports at \$1.4 billion (see Table 8). Comparable US trade with the region was \$2.7 billion in exports and \$1.7 billion in imports. The region's growing trade deficit with Japan in recent years has in part reflected and been facilitated by the increased flow of long-term capital from Japan. On the average, about a third of the trade deficits between 1960 and 1965 were covered by the flow of Japanese long-term capital, and most of the rest was financed by the less developed countries out of credits received from multilateral agencies and hard currency earnings on other markets.

Japanese trade with Free Asia grew rapidly between 1960 and 1965, when exports to this area increased almost 11 percent and imports 9 percent annually. Nevertheless, because the overall expansion of Japanese trade was even more rapid, * the Free Asian shares in total Japanese trade declined. Thus exports to Free Asia in 1965 represented 26 percent of Japan's total exports, a significant relative decline from the 32 percent of Japanese exports that had gone to the region in 1960. Similarly, the Free Asian share of Japanese imports declined from over 20 percent in 1960 to about 17 percent in 1965. Both of these trends were continuations of secular declines from corresponding shares of 36 percent for exports and 27 percent for imports in 1955. Although some significant changes occurred in 1966 in the patterns of trade with some Free Asian countries -- primarily because of the cessation of insurance of exports to Indonesia, the war in Vietnam, and the beginning of normalization payments to South Korea -- the relative shares of Free Asia in Japanese exports and imports (27 percent and 17 percent, respectively) showed little change from 1965.

The overall expansion of Japanese trade was spurred on by remarkable growth in the already large exports to the United States and other advanced countries and by increased imports from countries outside Free Asia. Both of these overall growth patterns are likely to persist. A sustained increase of exports to advanced countries is likely because Japan is continuing to develop its productive capacity and international competitiveness in those sophisticated lines of manufactured consumer goods that are

* Japan's exports grew at an average annual rate of 15.8 percent from 1960 through 1965. Over the same period the import growth rate was 12.7 percent.

most easily marketed in high-income countries.* A continuation of the decline in the share of Japanese imports originating in Free Asia is equally probable because, first, the rapid pace of expansion of Japanese requirements for industrial raw materials significantly exceeds the rate of growth of production of most of these commodities in Asia, and second, the Japanese government and importers are making every effort, within the bounds of sound cost relations, to diversify their sources of raw materials.

As long as the growth of Japan's trade continues to outpace that of the less developed countries of Free Asia, it will be possible for the share of these countries in the Japanese market to fall while Japan's share in the region's market grows. Thus, despite the relative changes described above, the share of Free Asian exports going to Japan increased from 10 percent in 1960 to about 13 percent in 1965, and the Japanese market share of Free Asian imports increased correspondingly from 13 percent to almost 18 percent. These increases are continuations of a longer trend, for in the period since 1950, Japan has been the country showing the largest gain in market shares in the region's trade.

The growing role of Japan in the trade relations of the other Free Asian countries has tended to increase the attention paid by their governments to adverse bilateral trade balances with Japan. In recent times, Pakistan and Cambodia, among other countries, have expressed considerable anxiety over the size and persistence of their bilateral trade deficits with Japan, and, in the latter case, this anxiety has resulted in a requirement that an existing trade agreement be renegotiated every six months. Concern for bilateral trade deficits can be expected to lead to greater pressure on Japan to apply corrective measures such as forms of regional preference and assistance in diversification of export commodities of the region.

The patterns of change in Japan's shares of the imports and exports of Free Asian countries, which are shown in Table 9, vary significantly by country. Notable increases in shares of the market have occurred

* Some 70 percent of the value of US imports from Japan are goods related to personal consumption expenditures. These include such items as metal manufactures, cameras, radios, television sets, motorcycles, and sporting goods.

with respect to such relatively important regional trading partners as the Philippines, * Indonesia, and Thailand. Despite much greater rates of growth of global trade for Japan than for India, the Japanese shares of the Indian market have declined slightly. Tables 8 and 9 also show that, among the major Asian trading partners, trade with Malaysia has suffered the greatest relative stagnation, and Japan's shares of that country's trade have declined markedly. A recently concluded development credit for \$50 million to be disbursed by Japan over five years, growing Japanese private investment, and the reopening of reparations discussions may provide the necessary stimulants to the Malaysian trade.

Table 9

The Japanese Share of the Market in Free Asian Countries
1960 and 1965

Country a/	Percent of Country's Exports to Japan		Percent of Country's Imports from Japan	
	1960	1965	1960	1965
Philippines	25 ^{b/}	28	18 ^{b/}	24
India	6 ^{c/}	7	5 ^{c/}	6
Nationalist China	38	31	35	40
Indonesia	15 ^{b/}	20	21 ^{b/}	38
Thailand	18	19	26	32
Malaysia	16	16	7	10
Hong Kong	6	6	16	17
South Korea	51 ^{b/}	26	23 ^{b/}	37
Singapore	1	3	7	11
Pakistan	7	4	9	10
Turkey	5	10	23	29
South Vietnam	3	10	22	9
Ceylon	3	2	8	8
Cambodia	7	5	17	17

a. Countries are shown in the order of their rank in 1965 trade turnover with Japan.

b. Because of statistical inadequacies or unusual trade patterns, data shown are for 1961.

c. Data are adjusted to include Portuguese India in 1960.

* The Philippines provides the one instance in which the data are adequate to separate reparations deliveries from normal commerce. Thus subtracting reparations from Philippine imports from Japan in 1960 and 1965 yields an increase in the Japanese share of the Philippine import market from 16 to 20 percent.

B. Commodity Composition

Japan's trade with Free Asia can still be categorized broadly as an exchange of manufactures for raw materials, but important modifications have occurred within this pattern in the postwar era (see Table 10). Major factors in these changes have been the steady growth of heavy industry in Japan and that of light industry in the less developed countries of Free Asia. Growth of Japanese heavy industry has both facilitated and been supported by a continuing shift from light to heavy industrial manufactures in Japan's exports to the region, although in recent years the rate of growth of heavy industrial exports from Japan to the advanced countries has exceeded that for such exports to Free Asia. At the same time, the growth of light industries and increased protection for their products in the less developed countries has led to a decline in the share of such traditional Japanese exports as textiles in total trade. Japanese imports from Free Asia have also been affected by the steady growth of heavy industry at home. To sustain rates of expansion of industrial output in Japan that exceed the annual increases in supply of raw materials in Free Asia, additional sources of primary commodities have been sought throughout the world. The dimensions of this problem of divergent growth can be partially perceived in Figure 8.

The data on shares of various commodity categories in Japanese trade with Free Asia highlight the rapid growth of exports of capital goods to the region. Such growth derives directly from the increased demand for these goods in the development programs of Free Asian countries, for from 1960 through 1964 the Japanese share of the market in the region's imports of machinery and transportation equipment held steady at 17 to 18 percent. Some significant changes have occurred in the mix of these Japanese machinery exports since 1960. Taken together, electrical and general machinery have moved from a position in which they accounted for about half as large a share of exports as textiles in 1960 to one in which their combined share was greater than that of textiles in 1965. The fact that the share of general machinery in trade with Free Asia has been greater than its share in Japan's total trade is indicative of the important role the region plays in providing a market for Japan's heavy industrial exports. This is particularly true for such items as metalworking machinery, textile machinery, internal combustion engines, and cargo-handling equipment. The share of exports of electrical machinery in Japan's trade with the region has lagged somewhat behind the corresponding share in Japan's total trade, but Free Asia has accounted for well over half of Japan's exports of heavy electrical equipment, such as generators, motors, and transformers.

Total 10
Commodity Composition in Japanese Trade with Free Asia
1960-65

	1960		1961		1962		1963		1964		1965	
	Value	Percent	Value	Percent	Value	Percent	Value	Percent	Value	Percent	Value	Percent
Japanese imports												
Plastics	1,940.8	41.30	1,440.0	42.8	1,175.5	36.1	878.2	23.0	330.4	25.5	360.3	25.6
Non-metallic mineral products	1,409.3	30.00	1,372.9	39.0	1,660.1	50.3	1,528.6	68.6	705.8	59.2	837.2	59.8
Mineral products	817.1	17.25	1,046.6	30.7	1,035.0	30.7	1,081.9	29.0	1,091.0	8.4	1,111.1	7.9
Manufactures	371.7	7.8	48.7	1.4	64.3	1.9	63.1	1.7	84.9	6.6	93.3	6.6
Other (residual)	4.3	0.09	2.8	0.08	3.2	0.1	2.1	0.06	3.1	0.3	4.3	0.3
Total imports	4,643.2	100.0	3,350.2	100.0	3,277.1	100.0	3,210.2	100.0	1,293.2	100.0	1,406.2	100.0
Japanese exports												
Chemical and pharmaceutical products	107.3	8.4	121.8	8.9	128.1	10.8	168.2	10.5	178.1	10.0	230.9	10.5
Textiles	900.3	27.6	355.5	27.7	339.8	23.2	353.8	21.4	378.3	21.2	459.9	19.6
Metal and metal products	227.7	17.4	233.1	16.8	247.1	16.9	289.4	18.0	343.6	19.3	428.7	19.5
General machinery	122.0	9.5	126.7	9.8	122.3	11.8	159.9	9.9	214.8	12.1	280.6	12.8
Electrical machinery	72.8	5.6	87.0	6.3	123.9	8.5	147.7	9.2	176.7	9.9	207.7	9.5
Transportation equipment	175.9	13.5	177.3	13.0	156.7	10.3	236.5	12.8	177.9	10.0	259.1	11.8
Other (residual)	238.6	18.2	269.5	19.5	246.8	18.1	292.4	18.2	312.9	17.5	350.0	16.3
Total exports	1,406.6	100.0	1,408.4	100.0	1,464.7	100.0	1,607.2	100.0	1,782.3	100.0	2,194.9	100.0

a. Including animal and vegetable fats and oils.

b. Excluding some miscellaneous manufactures such as instruments for 1960 through 1962 but including them for 1963 through 1965.

c. Data for 1963 through 1965 focus partly might change in the range of commodities included in this category.

in recent years. Although the relative share of transportation equipment in Japan's trade with Free Asia declined slightly between 1960 and 1965 and was significantly less than the share of this category in Japan's total trade, the region is still the principal market for exports of railroad rolling stock (see Figure 9) and an important recipient of automobile exports. Rapid growth in exports of rolling stock and motorcycles to Free Asia in 1966 suggests some recovery of the share of transportation equipment in trade with the region.

The increased share of metals and metal products in Japan's trade with Free Asia also reflects the growth of industry and construction activities in the region. By far the largest share of this category is made up of basic iron and steel products such as sheets, shapes, bars, pipes, and tubes. Rapidly expanding capacity in Japan's steel industry, distinctly competitive prices, and a solid international reputation for its products suggest that, despite any impact of recent US measures^{*} to enforce a stronger "Buy American" policy in procurement of steel products for overseas aid activities, Japan's exports of steel products to Free Asia will continue to grow at a fast pace.

Conspicuous growth has also occurred in Japanese exports of chemicals to Free Asia. Japan's market share in the region's imports in this category moved from about 15 percent in 1960 to about 20 percent in 1964. A small but rapidly growing element of the trade with Free Asia has been Japanese exports of plastics, which increased from about \$12.7 million in 1960 to \$37.9 million in 1964 and \$49.8 million in 1965.^{**} The greatest part of the trade in chemicals, however, has been accounted for by fertilizers. A relatively slow and faltering growth in exports of chemical fertilizers to Free Asia from 1960 through 1964 gave way to a sudden spurt in 1965, and exports to the region for that year were \$84.6 million, or 52 percent of total Japanese fertilizer exports. Further growth in fertilizer exports to Free Asia is likely, as the Japanese government is persuaded by other aid donors to increase commodity assistance in its bilateral aid programs. Another factor favoring such growth would be the creation of a revolving fund of \$25 million for long-term, low-interest

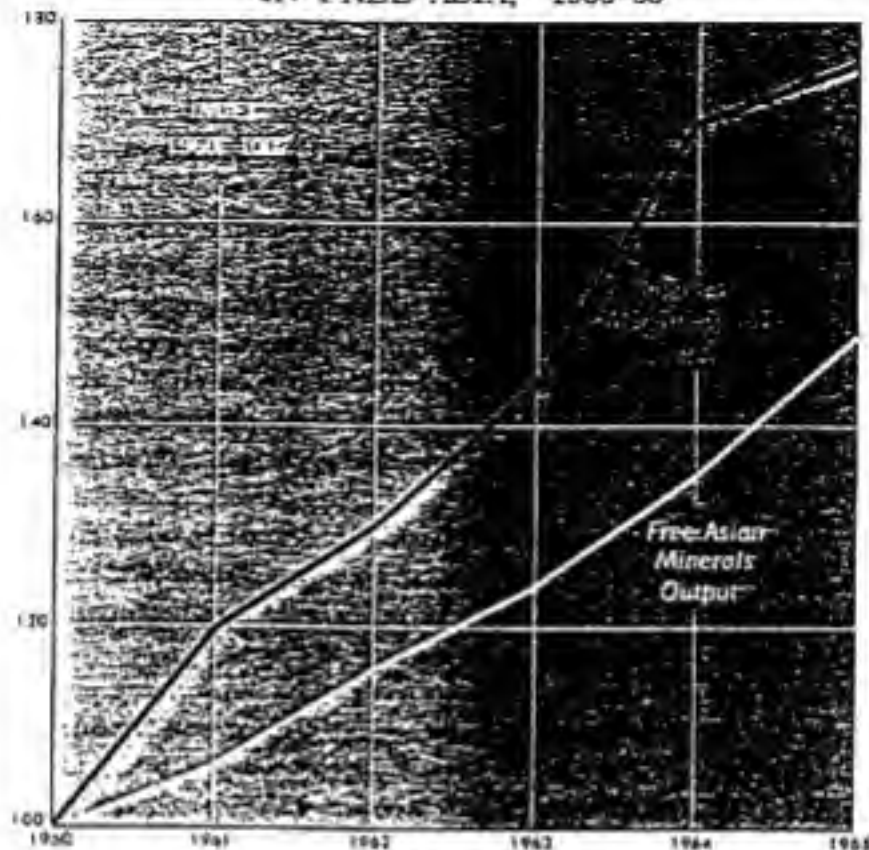
* The impact of these measures on Japan is indirect. Japanese sheet steel galvanized in South Korea and Taiwan for shipment to South Vietnam is most directly affected, but a declining market for the galvanized sheet in South Vietnam reduces import demand for Japanese iron sheet in South Korea and Taiwan.

** The growth of shipments of synthetic plastics, among which polyvinyl-chloride resin is a particularly important component, is another reflection of the development of light industry in the region.

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Figure 8

MANUFACTURING OUTPUT IN JAPAN
COMPARED WITH MINERALS OUTPUT
IN FREE ASIA,* 1960-65



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*Mineral index is for ECAFE countries, which include Free Asia and Iran. Inclusion of Iran tends to bias data upward.

FIGURE 9

JAPAN: ROLLING STOCK EXPORTED TO FREE ASIA



INDIA: JAPANESE-BUILT ELECTRIC LOCOMOTIVE



THAILAND: JAPANESE-BUILT DIESEL-ELECTRIC LOCOMOTIVE

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fertilizer loans to Southeast Asian countries that was under consideration in the Ministry of International Trade and Industry in mid-1966.

The most prominent feature of Japan's imports from Free Asia is the steady decline of the share of raw materials in total trade from 71.0 percent in 1960 to 59.5 percent in 1965. This relative decline has been accompanied by a proportional drop in the share of mineral fuels over the period. A corresponding increase in the share of foodstuffs reflects more transitory demand factors, the nature of which is discussed below. Japanese imports of raw materials and mineral fuels from Free Asia grew at annual rates of 5.2 and 4.9 percent, respectively, while the rates for total Japanese imports of these goods were 7.8 and 17.0 percent. The growth of Japanese imports from Free Asia will depend mainly on the regional supply of raw materials for some time to come. Further growth in Japanese food imports from the region is not likely to be great, and even a rapid rise in demand for imported manufactures, which accounted for less than 7 percent of Japanese imports from Free Asia in 1965, will have little overall effect over the next few years.

Changes in the Free Asian share of the Japanese market for certain important raw materials are shown in Table 11. This table particularly highlights the falling shares of Free Asia in Japan's imports of iron ore, sawlogs, and crude oil, which together account for about 40 percent of the value of Japan's imports from the region. In the cases of sawlogs in the Philippines and iron ore in the Philippines and Malaysia, increased domestic consumption is or may soon become a significant factor in restricting the amounts of the commodities available for export. Generally, however, the problem has been the slow growth of production in the region. Increased foreign investment and managerial participation in the exporting countries' extractive industries probably will be necessary if production of quantities and qualities satisfactory to Japanese importers is to be achieved. The alternative may be a greater Japanese emphasis on participation in the development of sources of raw materials in countries with more liberal investment policies such as Australia, Canada, and the United States. These three countries have recently assumed more important roles in current and prospective Japanese imports of hard minerals, petroleum, and natural gas. A more remote, but still plausible, alternative is Japanese investment in Siberia on a production-sharing basis.

That Japan has been able to evolve satisfactory production-sharing arrangements with Indonesia in petroleum and timber extraction indicates that obstacles imposed by tight government control of the minerals industries in less developed countries are not insurmountable for Japanese

Table 1)
Share of Free Asia in the Japanese Market for Selected Commodity Imports
1960-65

Commodity and Principal Free Asian Sources a/	Commodity's Share in Total Japanese Imports		Commodity's Share in Japanese Imports from Free Asia		Free Asian Share of the Japanese Market			
	1965		1965		1960	1961	1962	1964 1965
Cereals and cereal preparations b/ (Thailand, Thailand, Burma)	6.0			5.1	9.7	7.7	10.6	10.3 14.6
Sugar (Sri Lanka, Taiwan)	1.9			6.0	48.4	40.7	50.2	45.3 53.8
Raw cotton (India, Pakistan)	5.4			2.6	8.7	8.5	11.1	13.2 8.4 8.4
Hard and hard fibers (Thailand, Philippines, Pakistan)	9.4			2.1	76.9	75.2	75.4	78.7 81.6 84.7
Rubber, all kinds (Indonesia, Thailand, Malaysia)	1.6			7.2	80.3	77.4	76.8	74.4 75.4 78.6
Iron ore (Malaysia, India, Philippines, Thailand)	6.4			15.8	73.8	60.4	55.6	53.1 47.7 42.5
Nonferrous metal ores (Philippines, India, Malaysia, Indonesia)	3.5			5.8	30.8	30.7	29.6	30.3 28.3 28.4
Or which:								
Bauxite (Malaysia, Indonesia)	0.2			0.8	87.8	83.4	84.8	83.4 68.2 67.7
Copper ore (Philippines)	1.3			2.9	30.5	31.2	30.3	33.1 30.9 38.4
Crude oil (Indonesia)	12.8			5.7	15.2	13.9	11.7	10.9 9.4 7.7
Excludes (Philippines, Malaysia, Taiwan, Indonesia)	6.0			18.3	72.2	54.2	56.4	56.5 50.1 52.2

a. Principal sources are identified for background only. The first column of data is concerned with Japanese global trade; data in all other columns apply to Free Asia.

b. Excluding native and sorghum or feed grains.

investors. Unfortunately, however, the domestic political and economic turmoil in Indonesia has made this a poor test of performance in output. Recent production-sharing agreements between Japanese investors and the Indonesian government call for extensive exploration to begin in 1967 both south and east of Borneo to complement existing Japanese oil development activities in northern Sumatra. With the exception of Sumatran onshore fields which are currently producing, however, these development activities probably will contribute little or nothing to Japanese petroleum imports until after 1970 and are not likely to offset the decline in the Free Asian share of the Japanese petroleum market significantly until much later than that.

A clear example of some of the difficulties encountered in expanding production of raw materials in Free Asia in response to Japanese import requirements is iron ore extraction in India. In this instance, despite the challenge raised by large Japanese contracts with Australia for supply of pelletized ores, an Indian delegation took the occasion of an ECAFE meeting in mid-1966 to propound an official view that, were lump ore from India not purchased by Japan at the same premium prices as Australian pelletized ore, it would be a definite sign of Japanese indifference to Indian economic development. This argument completely begged the crucial issues of improvement of India's ore extraction and processing facilities, changes which might be effected by more liberal attitudes toward foreign private investment.

As impressive as the declining share of raw materials is the growing share of foodstuffs in Japan's imports from Free Asia. Comparison of Tables 10 and 11 suggests that, particularly since 1961, cereals (which accounted for about 20 percent of foodstuffs imported from Free Asia in 1965) have had a prominent role in this growth. In fact, rice imports from Free Asia, the United States, and Communist China have increased greatly since 1961, but leveling demand for rice and greater government emphasis on research to increase yields will probably reduce import demand in the long run. Indeed, a 10-year forecast of Japanese agriculture done in late 1966 projected a 10-percent growth in rice production accompanied by a decline in per capita consumption that would leave Japan virtually self-sufficient in rice.

Free Asian exports to Japan of foodstuffs other than rice have better prospects. One commodity that has made considerable headway in the Japanese market has been maize, primarily for use as a feed grain. Thailand has been a major beneficiary of this expansion, as Japan's maize imports from this source have increased from less than 50,000 tons per year prior to 1958 to over 500,000 tons per year since 1964. Prospects

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for further expansion are generally good as Japanese meat consumption steadily increases, but Thailand and other Free Asian exporters will have to remain competitive with the United States.

Particularly strong growth has also been sustained in recent years by such tropical products as bananas and canned pineapple, which together accounted for 19 percent of the value of foodstuff imports from Free Asia in 1965 compared with 10 percent in 1960. Tropical fruits will probably continue to encounter an expanding market in Japan for years to come. Sugar, primarily a tropical product, has performed less impressively in Japanese imports from Free Asia. In 1965 this commodity accounted for 23 percent of the value of foodstuff imports from the region compared with 39 percent for 1960. Nevertheless, the annual growth of sugar imports came to about 9 percent over the period. Large amounts of sugar probably will continue to be imported because domestic production meets only about 25 percent of Japan's requirements at present and domestic consumption is growing at about 6 percent annually. With this expansion of domestic demand, Japan could be an important purchaser of Philippine sugar if that country were forced to make its way on the relatively depressed international market rather than enjoying premium prices in the United States.

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IV. PROSPECTS FOR JAPANESE ECONOMIC LEADERSHIP IN FREE ASIA

The explosive growth of industry and the steady rise of the standard of living toward European levels have given Japan a legitimate claim to the economic leadership of Asia. Only in the last few years, however, has Japan begun to assume a significant share of the responsibility for active leadership in helping to meet the development problems of Free Asia. In no small measure, the hesitation of the past was a result of the time required to overcome antipathy toward Japanese imperialism in the region during the 1930's and 1940's. An equally important deterrent to more active Japanese concern for Free Asian economic problems was the national preoccupation with rehabilitation and closing of the gap between Japanese and European stages of economic development. As a steadily increasing stream of indicators has attested since about 1964, however, Japan has arrived as an advanced industrial nation, and this fact is understood by the Sato administration if not by the Japanese people as a whole. Although continued Japanese economic growth is itself vital to the security and general prosperity of Free Asia, it is also fair to question the extent to which the Japanese government is prepared to go in providing long-term capital and skills required in the development programs of Free Asia. It is only in this last sense that Japanese economic leadership in the region can legitimately be judged, for Japan has the less constructive option of simply withdrawing into its new role as a member of the community of advanced nations.

A. The Outlook for Increased Japanese Aid

Two aspects of the current stage of development of Japanese aid programs and policies complicate the task of estimating the prospects for increased Japanese aid to Free Asia. The first of these is the lack of coordination in the administration of aid. The Japanese government not only has no real equivalent of the US Agency for International Development (AID), but it is also burdened with radically different aid philosophies within its executive branch. Although the ultimate power in making decisions on the amounts and terms of aid generally rests with the Ministry of Finance, this office rarely articulates its general views on aid and, for the most part, restricts itself to conservative statements on the wide range of Japanese international obligations and the tightness of the Japanese capital market. Given the ministerial conflicts in the field of economic assistance, ambitious and visionary statements by the Foreign Ministry on how much aid Japan is willing to provide in any particular context generally must be discounted. On the other hand, it

is equally apparent that some of the reactionary attitudes of the Ministry of Finance have not been in tune with the more aggressive policies of Prime Minister Sato and the rest of his administration.

The second complication in estimating Japanese aid is the fact that Japan has only recently begun to seek a role in guiding development activities in the region. The implications of this fact are that Japan is moving out of an era in which obligations for capital assistance were both fairly well defined and assumed under pressure from other countries into one in which the initiative for development aid in as yet unspecified amounts must come more frequently from the Japanese government itself. Symbolically, this is the difference between a reparations program negotiated with Burma and more recent Japanese efforts to drum up support among lukewarm capital donors for a dam project of the Mekong Committee in Cambodia. Although creative Japanese response to the development of Free Asia suggests an ultimate requirement for better internal coordination of aid policies and programs within the Japanese government, the current status of Japan's initiative is that of a considerable array of specific suggestions by private and public agencies for particular projects. Thus we may know that elements of one ministry support a revolving Japanese fund for fertilizer loans and technical assistance in agriculture while other elements in the same ministry back an internationally subscribed agricultural development fund for Free Asia without knowing what, if any, relation the two approaches bear to each other. The enthusiasm that Japanese official and private agencies have recently shown for conjuring up grandiose Free Asian development schemes* in some respects has been an overzealous response both to President Johnson's \$1 billion aid proposal and to the spirit of their own ministerial conferences. This positive initiative, however, is bound to be tempered by a traditional Japanese realism concerning the absorptive capacities of the less developed countries of Free Asia.

Within the limits imposed by these problems, some crude estimates still seem warranted. First, the Japanese government has publicly repeated the goal of 1 percent of national income as an annual target for

* In addition to some of the less ambitious schemes such as the agricultural development fund and the fertilizer fund, the Japanese press in 1966 reflected discussion of an Asian Seaway (that is, extensive maritime rehabilitation) project, a Southeast Asian submarine cable, a substitute television satellite network, and a long-range purchasing program for imported rice.

long-term capital flow to the less developed countries with sufficient frequency that it is hard to believe that it will not be approximated at least by 1970. Allowing for growth of national income between 1965 and 1970 at an annual rate of 8 percent, this would mean that Japan's official and private development assistance would amount to \$1.0 billion in 1965 prices for 1970. Although the shares of Japanese official aid going to Africa and Latin America have grown in recent years and private capital flows are likely to continue to be distributed widely, Free Asia would probably receive at least as large a share of the long-term capital flow as it did for the period from 1960 through 1965.* This would mean a combined official and private assistance flow of \$600 million or more in 1965 prices to the region in 1970.

Second, most of such assistance to Free Asia probably will be in the form of long-term credits, although, within the private sector, export credits will probably be matched by direct investment. The most prominent exceptions to this rule would be the official reparations and grants already projected or now under discussion for Burma, the Philippines, South Korea, Indonesia, the ADB, and other multilateral funds. The terms of official bilateral credits would probably be softer than the rate of nearly 6 percent that prevailed for almost all such credits until quite recently. Within this context, it appears likely that the activities of the OECF would expand to facilitate softer loans without complicating or jeopardizing the normal commercial loan activities of the Export-Import Bank. The predominant credit activities would probably be made more flexible with respect to use for commodity (as opposed to project) assistance, but use of credit funds would still be tied to procurement in Japan.

Third, Japan probably will concentrate most of its bilateral aid activities in Southeast and East Asia. This does not rule out a significant continued role within the consortia for India and Pakistan, but it does suggest that Japanese official aid and private investment activities in the other countries of Free Asia will grow at a faster pace. In addition to the principal recipients of major grant assistance identified above, official Japanese aid in the form of credits will probably be an important source of developmental capital in Thailand, Malaysia, and Taiwan in 1970. Private investment will continue to focus on Thailand, Indonesia, and Malaysia, and, with modest improvements in the climate for Japanese investment, will pick up significantly in the Philippines

* See II, above.

and South Korea. A last point to be considered is that increasing Japanese enthusiasm for multilateral aid activities may mean more suggestions and programs for special development funds for Southeast Asia.

B. The Future of Japanese Trade with Free Asia

Over the last 10 years the Japanese have shown increasing awareness of the relation of expanded economic aid to the long-run growth of Japanese exports to Free Asia. The prevailing view among the Japanese has been that the stimulative effects of foreign aid to trade consist merely of financing exports and helping to introduce Japanese products. Accordingly, budget proposals for economic assistance have long been presented to the Diet as "trade promotion" expenditures. This view is changing, however. Japan has now established its competitive strength in heavy industrial exports; and overseas investments in manufacturing, such as those shown in the list above, * have secured a favored position for Japan in future Free Asian imports of a variety of semimanufactures and producers' goods. Under these circumstances, it has become more apparent that the principal limitation on the growth of Japanese exports to Free Asia is the prevailing level of income in the region. Although Japan will probably continue to enlarge somewhat its market shares in the trade of the region's less developed countries, the primary means for further stimulation of Japanese exports to Free Asia will have to be an expanding market based on sustained economic development. The Japanese are beginning to recognize that they are likely to benefit from any aid which stimulates the area's economic development. Thus participation in multilateral aid to Free Asia is seen increasingly to be in Japan's commercial interests.

Viewed from the perspective of the less developed countries of Free Asia, the crucial trade issue is how to increase Japanese imports from the region. As in the past decade, when the Japanese economy grew about 10 percent annually, the Japanese market will expand rapidly. Nor are Japanese trade restrictions a problem, except for a few agricultural products and manufactures. The most important factor limiting Japanese imports from Free Asia will continue to be the slow growth of production of industrial raw materials in the region.

* See Figure 6, p. 39, above.

The most direct means of increasing Free Asian minerals production is what the Japanese frequently refer to as the "development and import formula." This method is based on such facets as Japanese government credits, private investment, and technical assistance for the development of a primary product required by Japan. Instances of application of one or more of the facets of this approach are maize in Thailand, iron ore in India, copper ore in the Philippines, crude oil in Indonesia, and timber in Malaysia and Indonesia. Through the Ministry of International Trade and Industry, the Japanese government covers up to three-fourths of the expenses of surveys and technical assistance related to the development of sources of primary products in the less developed countries.

Perhaps more than anything else, the combination of government assistance in initial surveys, government facilities for long-term loans to Japanese private investors, and long-range contracts for purchases of Free Asian minerals under production-sharing has elicited cries from a variety of Western sources that the Japanese are seeking to reconstruct the Greater East Asia Co-Prosperity Sphere. This concern appears unwarranted, for the Japanese have shown a strong preference for a wide distribution of sources of raw materials, and the external features of what is characterized as a new form of purposive Japanese imperialism can be too readily explained on purely economic grounds. Thus Japanese credit assistance to private investors in Free Asian minerals production is most plausibly seen as an attempt to overcome problems of high domestic interest rates stemming from strong competing demand for domestic investment. Similarly, Japanese participation in minerals surveys is primarily a reflection of the fact that governments in the region have inadequate knowledge of natural resources and, for the most part, have done little to overcome this obstacle to foreign investment.

Two considerations that tend to favor mineral development through Japanese overseas investment over similar agricultural development are the prospects for continued expansion of the large Japanese demand for raw materials for heavy industry and the advantage to the less developed countries of dependence on exports, the supply of which is not subject to such random shocks as bad weather. On the other hand, the extensive application of the "development and import" method to agricultural diversification could have greater direct impact on the standards of living of rural population in many areas of Free Asia. If this diversification were directed toward tropical agricultural products having relatively high income elasticities of demand in Japan, the prospects for an expanding market in Japan would be enhanced.

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A less satisfactory approach to the problem of expanding Japanese imports from Free Asia is that of providing preferences to the less developed countries in this region. Given the Japanese adherence to the General Agreement on Tariffs and Trade and other commitments to international bodies, this method would depend on subsidies for Japanese importers rather than any direct preference scheme. The issue of preferences to less developed countries is presently under heated discussion among advanced countries, but there are at least two reasons why this sort of solution to the problem of large trade imbalances with Free Asian countries is not likely to be satisfactory. First, unless preferences were extended across the board to all less developed countries, the political conflicts that such a system would engender would be monumental. In the absence of regional preferences, however, there is only limited reason to believe that Free Asian primary exports would benefit much. Second, although preferential treatment might divert Free Asian exports of raw materials to the Japanese market, this diversion would probably have only limited impact on the production of such commodities.

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The Okinawan Issue in Japanese Politics

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THE OKINAWAN ISSUE IN JAPANESE POLITICS

The growth of irredentist sentiment toward Okinawa within all Japanese political parties is reflected in the Sato government's groping for a responsive but responsible policy toward reversion of the US-administered Ryukyu Islands to Japan. Growing national pride and mounting resentment that nearly one million ethnic Japanese in the Ryukyus have remained under alien control for over 20 years account for the rising emphasis on this issue. The government recognizes the importance of the US bases to Far Eastern security and is beginning to study the feasibility of acquiring administrative rights in the islands while preserving the viability of US bases. It may try to negotiate the problem with the US this year or next in order to settle it and keep the subject out of the public debate over the US-Japan Mutual Security Treaty when the treaty is subject to review in 1970.

Expectations of Reversion

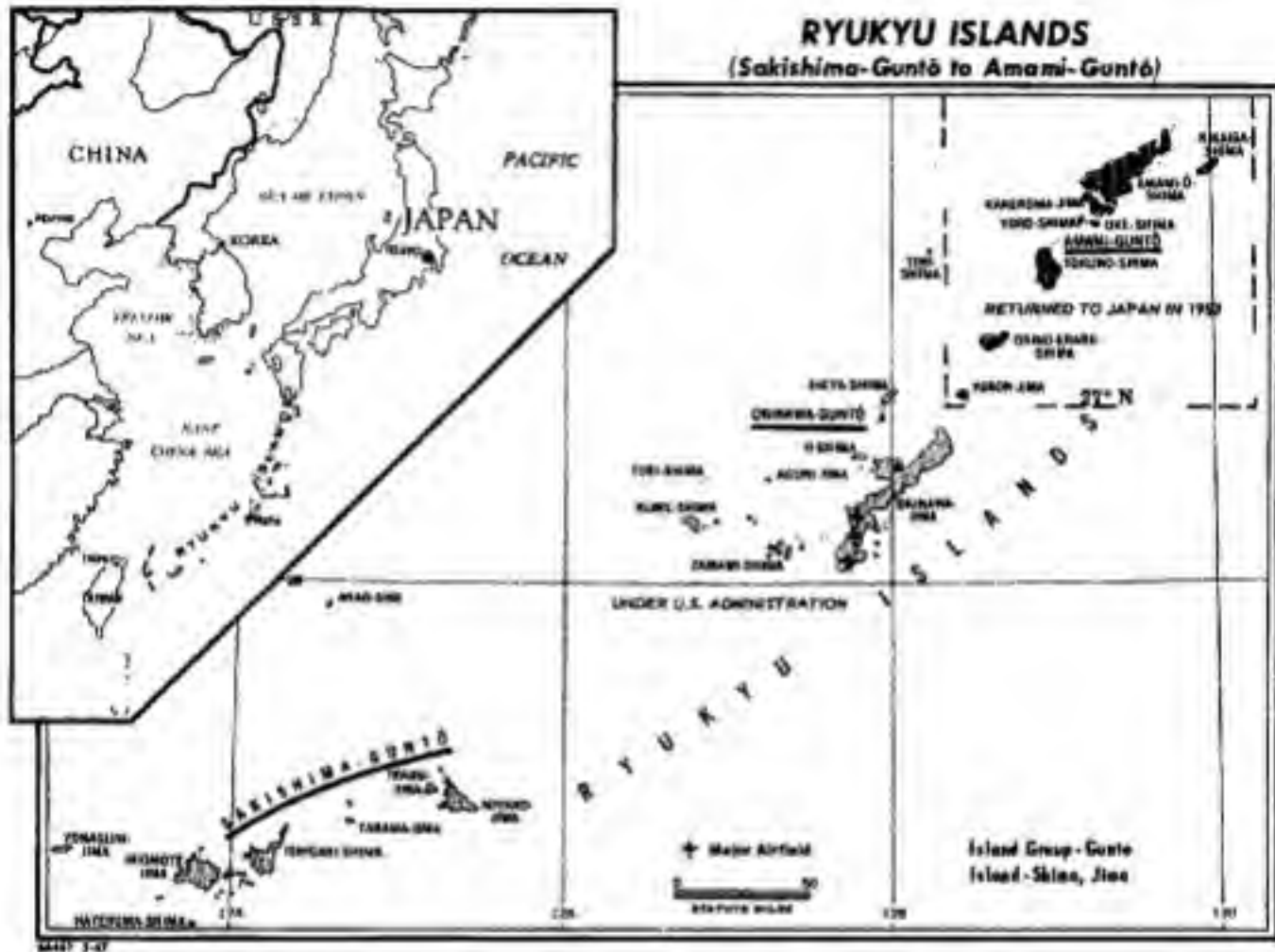
The US, in accord with the concept of residual sovereignty, has recognized Japan's ultimate claims to its prewar prefecture of Okinawa. The US maintains that the reversion to Japan of these islands is contingent on the relaxation of tensions in the Far East sufficient to make US bases unnecessary. As the self-confidence, national pride, and ambition of the Japanese grow, so does their impatience with the lack of clear progress toward their final goal of reversion. Articulate Japanese are asking for a schedule of tangible progress. They consider this only consistent with Japan's place in the world and with its alliance as a partner of the US.

The reversion problem has drawn noticeably more attention since Prime Minister Sato visited Okinawa in August 1965. At that time, he declared that the post-war era would not be over until Okinawa was returned to Japan. Sato's statement was hailed in both Okinawa and in Japan, and he is constantly being reminded of it. The use made of the reversion issue by all political parties, by the press, and on occasion by government officials anxious to assert their patriotism, testifies to the depth of sentiment on this subject.

For the most part, the Japanese Government has tried to control rising public expectations about recovering Okinawa in the near future. At the same time politics

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compels the Sato administration to show its "sincerity" by at least championing pro forma steps which can be interpreted as progress towards reversion. The government has a substantial record both in securing US concurrence in a rapidly expanding program of Japanese financial and technical aid to the Ryukyus, and in advocating US moves to grant Ryukyans a greater degree of self-government. The mainland Japanese tend to view aid and autonomy as but two aspects of an essential effort to reintegrate Okinawa with Japan. Of great symbolic significance to the Japanese has been the government's success this year in winning approval for displaying the Rising Sun flag--albeit beneath a pennant labelled "Ryukyus"--on Okinawan vessels.

Party Positions on Reversion

Many members of Sato's conservative Liberal Democratic Party (LDP), while taking all the credit they can for such concessions, are beginning to feel that the time is about over for temporary palliatives which do not solve the basic desire to establish a firm date for reversion. Far more than any of its rivals, the LDP recognizes the value of the US bases and is beginning to face up to the problems of preserving them. In the past, the LDP rank and file was content to accept a gradual increase of Japan's role in the Ryukyus, hoping that the US requirement for the bases would soon end. Under growing popular pressure for action, however, the LDP is

beginning to consider possible arrangements which would provide for Japanese administration of the islands but allow the US freedom to use its bases there, [REDACTED]

To date the LDP has not openly advocated such a compromise. It is inhibited [REDACTED]

[REDACTED] by public unwillingness to have Japan committed in any way to warfare in Asia. [REDACTED]

If the party advocated taking over administration of the Ryukyus while the bases remain, it would be open to charges of flouting the "no-war clause" of the Japanese constitution. The LDP is well aware that national sentiment demands a solution to the Okinawan problem. Party leaders, however, appear hopeful that growing public understanding of Japan's international position will resolve the dilemma in the context of Japan's defense role in the Far East.

All the opposition parties, led by the Japan Socialist Party (JSP), the chief opposition force, [REDACTED]

[REDACTED] They have mounted a pincers movement in current Diet debates seeking to trap the LDP between a "do-nothing" stand on reversion and a position which they could claim would open the way for the nuclearization of Japan.

The JSP demands the immediate unconditional return of the islands. All military bases there

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would be excluded, even any under the Japanese Self-Defense Forces, which the party considers unconstitutional. The Socialists maintain that the bases invite hostile attack on Japan, involve Japan in US strategy in Southeast Asia, and might drag Japan into war under the security treaty. The party has already launched a campaign to terminate the treaty in 1970, and regards the reversionist movement as the critical lever in that campaign.

Anti-Americanism has been a principal theme of the JSP since the early postwar years and underlies the party's appeal to Japanese nationalism on the Okinawan issue. The JSP's recent display of patriotic wrath over incidents of alleged desecration of the Rising Sun flag in Okinawa illustrated this approach.

Along more traditional Marxist lines, the JSP stresses the "colonial" exploitation of Okinawa by US "capitalist imperialism." It plays up the economic and social disparity between Japan and Okinawa to prove how far the Ryukyuans are lagging behind the motherland.

With the exception of the Communists, who try to outdo the Socialists in attacking the US, the small opposition parties make little use of anti-Americanism on the Okinawan issue. The moderate Democratic Party (DSP), which does not demand the immediate termination of the security treaty, is not committed to unconditional abolition of US bases in Okinawa and might tolerate them

in a "reverted" Okinawa [REDACTED]

The DSP fully recognizes the force of awakening Japanese nationalism. The Seamen's Union, the chief constituent of DSP's trade union backing, fired the opening gun in the campaign to allow Okinawan ships to fly the Rising Sun. This union is competing with a rival trade union federation supporting the Japanese Socialists.

The new Clean Government Party (Komeito), the mouthpiece of the Buddhist Soka Gakkai sect, has thrived on rising nationalism and exploits its reversionist aspects. The party calls for prompt reversion [REDACTED]

Komeito is keenly aware of the interests of its fast-growing list of converts on Okinawa, who have been remarkably successful in local elections there.

Party Relations With the Ryukyus

All of Japan's parties are involved in one way or another with parties in Okinawa. This ensures that whenever a reversionist issue arises in one place it is quickly reflected in the other. Only the LDP, because of its responsibility for governing Japan, ever uses its influence with the ruling Okinawa Democratic Party (ODP) to quiet things down. The party is not always successful, even though the ODP, like all Okinawan groups, looks to Japan for advice and guidance.

Petitions, testimonials, and delegations of Okinawan politicians are warmly welcomed by partisan

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problem advanced by LDP politicians, the government has so far managed to keep its options open. Each spring during the past three years it has sanctioned private or semiofficial visits to the US by champions of two sets of proposals for partial restoration of administrative rights.

Under the first of these plans, certain special functions, such as education and social security, would be assigned to Japanese administration. This approach was presented informally in the US by a Japanese mission in 1965, was espoused by the director-general of the prime minister's office following a visit to Okinawa in 1966, and is currently being presented in greater detail by a private mission to the US led by the head of a new advisory committee on Okinawa in the prime minister's office. This functional "creeping reversion" formula would create a condominium in which the piecemeal return of administrative rights to Japan would progressively diminish the US role. Sato's recognition of US opposition to this approach probably persuaded him to throw some cold water on it in the course of his election campaign last January.

The Japanese have also shown interest in a geographical approach. This called for the return of administrative rights by region, excluding US bases for the time being. Under a plan advanced by a fact-finding mission to the US in 1966, outlying islands would be returned to Japan, leaving Okinawa with its concen-

tration of bases under US administration. This particular scheme has apparently been abandoned, probably because it was feared that a partial solution on its lines would prejudice the prospects for the reversion of the majority of the Ryukyuan population, which lives on Okinawa.

To meet such objections and to show its responsiveness, the government seems to have turned recently to a far more comprehensive geographical approach. In February, the vice foreign minister bluntly stated in public that the only way to recover the Ryukyus "fully" was to assure the US free use of its bases, [REDACTED]

[REDACTED] The dilemma posed by his suggestion provoked considerable debate, which, however, was far freer of [REDACTED] hysteria than would have been the case even as recently as a year ago. This suggests that the government may soon decide to approach the US to work out some such arrangements.

Recent suggestions would leave the bases in US hands but return the rest of the islands' area--over 70 percent of the total--to Japan. Responsible Japanese officials have been made aware of the intricate involvement of the bases in most aspects of Okinawan life, but top leaders may have concluded that some sort of separation of the bases represents their only remaining possibility. At a high-level meeting in mid-March the Foreign Ministry reportedly came around to the views of the prime minister's office that the principal bases should be left

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sponsors in the homeland, thus increasing the pressure upon the government to "do something" about Okinawa. The government is often embarrassed by the troublesome persistence of the visiting islanders and by prominent government officials wooing "the Okinawan constituency," without regard for over-all government policies.

The leftist opposition in Japan has regularly joined the Okinawans in commemorating "Reversion Day" on 28 April, the anniversary of the signing of the peace treaty with the US which left the Ryukyus under US control. Marches are held in Japan and Okinawa, and Japanese and Okinawans meet at sea on the 27th parallel, the northern boundary of the US-administered Ryukyu Islands and a symbol of "divided Japan."

Government Policy Reappraisal

Stimulated by growing political and popular pressures for action, the Sato government has begun to reappraise its stand on reversion, both in preparation for debate on Okinawa in the current Diet session and in connection with plans for handling the security treaty issue in 1970. Beginning that year the treaty can be terminated on one year's notice; otherwise it continues in effect. The left has for several years been preparing for a repeat of the crisis surrounding the treaty's ratification in 1960, and there is bound to be widespread discussion of the

treaty even without formal Diet debate as 1970 approaches.

The political situation in the Ryukyus is another factor at least partly responsible for current interest in reversion. The Ryukyuan legislature has been paralyzed ever since February when mob action blocked consideration of two long-standing bills to curb the political power of the teachers. The crisis has caused grave concern for the ODP's fate in the elections scheduled for November 1968 when control of both the legislature and the executive could be lost to strongly reversionist forces. A new and popular stance on reversion by the LDP could help its sister party in Naha.

Despite these current pressures, some LDP reversionists seem to be concerned that sentiment for reunion with the homeland may wane among the rising generation of Okinawans. A recent public opinion survey in Okinawa indicated that strong reversionist sentiment is largely confined to Okinawans over thirty and that the younger generation moving toward positions of influence in the Ryukyus is the least sympathetic to the idea of joining a country it has never known. In Japan, some in government--and many outside--therefore may wish to seize the present occasion to formalize a plan for reversion before such a trend weakens Japan's chances.

In the face of a variety of proposals for solving the Okinawa

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under direct US administration so Japan could avoid responsibility for US activities in them.

Prospects

The government probably cannot afford to vacillate much longer on its approach to the reversion issue. It has bought peace in the present Diet session by acceding to opposition demands for a new committee on Okinawa. If the government can show some progress toward reversion, it may be able to head off an embarrassing and potentially explosive debate on relations with the US in general. To this end it will probably seek to open negotiations with the US later this year, or early next year.

The second aspect of the Sato government's efforts to dampen debate on Okinawa is to educate the public on Japan's defense needs in the nuclear-armed world. There are signs that this educational campaign is bearing fruit. For the first time since their defeat in World War II the Japanese are beginning publicly to consider defense problems realistically.

At the moment, however, this aspect of reviving Japanese nationalism--the new tendency to consider defense problems--still is weaker than reversionist sentiment, and it may remain that way. At any time, moreover, an incident on Okinawa might inflame nationalist passions and force the government into direct confrontation with the US. ~~(SECRET NO FOREIGN DISSEM)~~

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Wednesday, May 10, 1967

EO 12958 3.4(b)(1)-25Yrs
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TEXT OF CIA REPORT [REDACTED]

Ivan Ivanovich Kovalenko, Deputy Chairman of the Soviet-Japan Friendship Society who is now visiting Japan [REDACTED] said [REDACTED] on May 4, 1967, that "the American bombing of Haiphong will not increase the danger to Soviet ships. I am absolutely positive that the Americans will not bomb the Soviet ships by error. Therefore, the recent American bombing of Haiphong will not become a cause for greater tension between the Soviet Union and the United States. The Soviet Union will not be provoked by such American military operations as the Haiphong bombings." The Japanese word used for bombings can be translated as "accidental bombing or error in bombing."

Kovalenko also expressed his belief that there will be no quick solution to the Vietnam War and that the Soviet Union expects the war to continue for many years, perhaps ten or even twenty. He said that the Soviet Union will continue to help the Vietnamese as long as help is needed.

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1. *Barrow*

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3. *Rz'd 1/15/69*

MEMORANDUM FOR: Mr. Bromley Smith,
White House Staff
The White House

SUBJECT: Japan's Economic Role in the
Development of Free Asia

1. You may find of interest the attached report on Japan's economic role in the development of Free Asia.

2. Until quite recently, official Japanese aid to Free Asia centered on reparations. As these programs draw to a close, a coherent Japanese aid policy remains to be developed.

3. In spite of some inhibitions, the declared goal of one percent of national income for the annual flow of long term capital from Japan to the less developed countries probably will be achieved by 1970. At a rate of growth of 8 percent for national income, this would mean a flow in that year of \$1 billion in 1965 prices, and of this amount \$600 million or more might be expected to go to Free Asia.

Bill Moyall
WILLIAM N. MOYALL, JR.
Director
Research and Reports

Attachment:
CIA/RR IR 67-12 (Subject Report)

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11 January 1968

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NATIONAL INTELLIGENCE ESTIMATE

NUMBER 41-68

Main Trends in Japan's External Relations

Submitted by

Richard Taylor
ACTING DIRECTOR OF CENTRAL INTELLIGENCE

Concurred in by the

UNITED STATES INTELLIGENCE BOARD

As indicated overleaf

11 January 1968

Authenticated:

James S. Lutz
EXECUTIVE SECRETARY USIB

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CONTENTS

	<i>Page</i>
CONCLUSIONS	1
DISCUSSION	3
I. INTRODUCTION	3
II. THE ESTIMATE	4
A. General	4
B. National Security and the US Alliance	5
C. Japan in Asia	7
D. The "Pacific Community"	9
E. Elsewhere in the World	10
ANNEX	

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MAIN TRENDS IN JAPAN'S EXTERNAL RELATIONS

CONCLUSIONS

A. Japan is acquiring an increasingly important position in the international economic community; its remarkable economic growth will soon make it the third most productive nation after the US and the USSR. At the same time, Japan is becoming progressively more assertive in world and regional affairs. The constraints on Japan's willingness to seek international political responsibilities are bound to diminish further over time, nevertheless its acceptance of such responsibilities, and its exercise of influence and power in international affairs generally, will probably not increase to the degree suggested by its powerful economic position within the next 5 to 10 years.¹

B. We believe that Japan will continue to identify its basic interests with those of the US and the Free World over the next 5 to 10 years. In particular, it will probably devote important diplomatic efforts to cementing friendly relationships with its leading trading partners—the US, Canada, and Australia. These economic ties and an increasing similarity of political goals have aroused Japanese interest in the development of an informal grouping of advanced Pacific nations.

C. Japan will continue to rely primarily on the US for its strategic security. In relations with the US, Okinawa is likely to continue as a troublesome problem, but we foresee no effective opposition in Japan to the continued application of the US-Japan Security Treaty past 1970. During the next five years, Japan will probably not decide to develop nuclear weapons but it will keep the option open. It will also improve its conventional military capabilities, particularly its air and sea defense forces.

¹ The Director of Intelligence and Research, Department of State, believes that A greatly underestimates the probable significance of the political role Japan will play in the next decade.

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D. Japan will probably avoid direct military involvement in efforts to "contain" communism; in certain circumstances, however, the Japanese might be willing to accept a limited measure of responsibility for the defense of lines of communication in the Northeast Asian area.

E. Japan sees Communist China as a long-range competitor for influence in East Asia, but the Japanese will continue to avoid unnecessary provocation of Peking while working, mainly through economic means, to limit its influence. In the Japanese view, security in Asia can best be insured by the development in Peking of a less militant and more realistic view of the outside world; Japan will attempt to foster any such tendencies in China, taking care not to impair its own relationship with the US.

F. Japan will seek to expand its influence in South Korea and Taiwan, and in Southeast Asia, but its interests in the latter region are less compelling. Japan is reluctant to become deeply involved in the region's political turbulence, considers that security there is primarily the responsibility of the US, and is aware that Southeast Asia trade is not critically important to Japan's economy. Japan's most likely course for the next few years will be to continue its present emphasis on economic assistance; its role in the political field will probably grow but it will still move carefully, applying its influence in support of stability and regional cooperation.

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DISCUSSION

I. INTRODUCTION

1. The basic direction of Japan's foreign policy is unlikely to change over the next 5 to 10 years: Japan will continue to rely on the US for military security and to identify its basic interests with those of the US and the Free World in general. This policy is rooted in Japan's self-interest as seen by its ruling conservative leaders and by most moderate political elements, and is supported by a substantial majority of the population. Within this established framework, however, Japan is likely to become progressively more assertive in world and regional affairs, to take more initiatives in developing and protecting its national interests, and to be less restrained than formerly by pacifist and other emotions generated by World War II.

2. This outlook is already evident in the conduct of Japan's external relations. It is partly a result of the passage of time since the war and the rebirth of pride in being Japanese. Of equal importance, perhaps, is Japan's increasingly eminent position in the world economic community.² This has led Japanese leaders to assume growing international responsibilities in matters of trade liberalization, monetary affairs, and assistance to less developed countries. It has provided them with important leverage in the conduct of affairs with larger nations. And, inevitably, it will lead them toward a greater concern with political developments in areas of major interest to Japan.

3. The Japanese Government is opposed to the spread of Communist influence in Asia. As a matter of general policy, however, Japan is likely to avoid heavy involvement in efforts having as their declared purpose the containment of communism. Many Japanese, including some conservative leaders, do not see a direct Communist military threat to Japan at this time. With regard to the USSR, there is suspicion of its ultimate ambition in Northeast Asia but the Japanese, sure of the US umbrella, are relatively confident that the Soviets will not resort to force to achieve their objectives. It is generally believed in Japan that Soviet leaders will maintain their friendly pose in hopes of weaning Japan from the US alliance and preventing a closer Japanese relationship with Peking, as well as to keep open the possibility of developing an expanded Soviet-Japanese economic relationship.

4. Concern about Communist China has been growing recently, but few Japanese leaders expect a Chinese military attack on Japan. There is some appre-

² In terms of purchasing power of gross national product (GNP), Japan now ranks above France and the UK and is on the verge of overtaking West Germany to become the world's third most productive nation (after the US and USSR). In volume of international trade, it will surpass Canada and France and move into fourth place in the early 1970's (after the US, West Germany, and the UK). In the early 1980's, the people of Japan will achieve living standards comparable to those of the more advanced Western European countries. (See table and graph at Annex for 1966 Japanese trade statistics.)

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hension over the potentialities of China's massive armies, but little respect for its air or sea arms. China's recent progress in the development of nuclear weapons and delivery systems is causing concern among some informed Japanese, and the radicalism of the Chinese cultural revolution has had a disillusioning effect on Japanese generally. To the extent that there is concern in Japan over the Chinese military threat in the near term, it is now chiefly in terms of the possibility of war between China and the US in which Japan, with its US bases, might somehow become involved. This accounts in large part for the sensitivity of the Japanese to US military actions in Southeast Asia or elsewhere which might conceivably provoke Peking to fight. There is also growing concern that once the Chinese amass a nuclear arsenal, they will attempt nuclear blackmail.

5. There are other important reasons for continued reluctance in Japan to participate in military containment efforts in East Asia and elsewhere in the world. Japanese leaders are extremely sensitive over the health of an economy so dependent on foreign trade, and they are unlikely to pursue courses of action which might jeopardize profitable markets and critical sources of supply. Moreover, the Japanese people in general do not yet share their leaders' interest in assuming responsibilities overseas. There are still psychological restraints on political activity in Southeast Asia resulting from the war, but more important today are Japanese popular concerns with domestic needs. Despite Japan's brilliant economic performance, living standards in general are still below those of Western Europe and the populace is well aware of this. The discrepancy is particularly obvious in the public sector of the economy; roads, housing, and sanitation facilities are grossly inadequate, and there is considerable pressure on the government to raise budgetary expenditures to meet these needs. Finally, the very success of Japan's domestic and foreign policies in the past decade make for inertia and a reluctance to entertain very significant shifts of resources to defense or foreign aid.

II. THE ESTIMATE

A. General

6. In the following estimate, we start from the judgment that Japanese foreign policies will evolve in the context of continued conservative political predominance in a generally favorable economic environment, with high rates of economic growth likely through the early 1970's. We believe, in short, that the "mainstream" factions of the Liberal-Democratic Party will maintain their position of dominance for at least the next several years. After that, even if they should lose their commanding majority, power would probably pass to a moderate centrist coalition rather than to a Marxian Socialist government bent on drastic changes in domestic and foreign policy.

7. There are, of course, many external variables which could significantly affect our estimates: major changes in the US defense posture in the western Pacific; strong protectionist trends in US trade policy; worldwide constrictions of markets brought on, for example, by a general economic depression; significant

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changes in Communist China's attitude toward its neighbors; or increased belligerence on the part of the Soviet Union in the Far East. The implications of such contingencies are considered in this estimate.

B. National Security and the US Alliance

8. Despite the absence of any feeling of an imminent direct threat to their security, the leaders of Japan—as they contemplate the Communist giants on the Asian mainland—are sensible of the need for a powerful military protector. They prefer to see the US take this role. They also see the military alliance as an essential component in the complex of bilateral arrangements—political and economic—which have proven advantageous for almost two decades. Maintenance of these arrangements is strongly favored by the conservative leadership and by most middle-of-the-road political elements in Japan. We foresee no effective opposition, therefore, to the continued application of the US-Japan Security Treaty past 1970.²

9. The most troublesome problem in the security field is the status of Okinawa. National feeling against US occupation of the Ryukyus continues to grow and will in time cause the Japanese Government to press even more strongly for the return of complete administrative control. Prime Minister Sato has virtually committed himself before the electorate to obtaining, within the next few years, at least a timetable for "reversion." The Japanese may accept reversion under terms which would not bring US bases in the Ryukyus under the same restrictions as those imposed on US bases in the home islands—i.e., no nuclear weapons and prior consultation on major military deployments. Japanese attitudes in this connection will be greatly affected by the overall military environment in the western Pacific; a relatively peaceful situation would probably accelerate demands for reversion without special privileges. In any case, the Okinawa issue will probably be the most difficult problem in US-Japanese relations over the next few years. The US bases in Japan proper are no longer an important political issue, though they are seen by some Japanese as an embarrassing remnant of the Occupation and hence do constitute a residual irritant in bilateral relations.

10. During the next few years, it is probable that considerations of self-respect and national prestige as well as defense needs will lead the Japanese to improve their conventional military capabilities. The emphasis will be upon the development of air and sea defenses for the home islands. Japan will strive to become increasingly self-sufficient in the production of conventional armaments, not only for military and prestige reasons, but to save foreign exchange and establish new export lines.

11. We do not believe that Japan will make a firm decision during the next five years to develop nuclear weapons systems. Japanese nuclear "allergies" are

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²The "Treaty of Mutual Cooperation and Security" became effective on 28 ~~BASE-NOV-0000~~ 1960. Its term is indefinite, but after 10 years either party may terminate it after one year's notice.

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weakening, but they are still very strong. In addition, Japan could not utilize its existing nuclear facilities for weapons research and production without breaking a series of international agreements, including the projected nuclear non-proliferation treaty. Another obstacle would be the very limited supplies of high-grade uranium deposits in Japan and the difficulty of procuring sufficient unsafeguarded supplies from abroad. In any case, so long as the US alliance remains firm and the US discourages Japanese acquisition of nuclear weapons, it would be difficult for proponents of Japanese nuclear armament to justify publicly the heavy expenditures, although these would be well within Japanese economic capabilities.

12. The Japanese will not, however, foreclose the option to develop nuclear weapons systems. Continuing technological advances in the field of space rocketry will make the production of delivery vehicles progressively easier. The Japanese already have experience in building nuclear reactors for power generation and have an impressive supporting technological base. They have plans to build more power reactors and chemical separation facilities to process the plutonium produced in such reactors. Recent Japanese studies have indicated to them a probable future need for an independent capability to produce enriched uranium fuel. Such facilities, though designed for civilian needs could, of course, produce material for weapons.

13. *Contingencies.* In certain contingencies, Japan might give serious consideration to the development of nuclear weapons. For example, failure to achieve effective nuclear nonproliferation agreements and the acquisition of nuclear weapons by India would probably encourage some Japanese nationalists to demand nuclear weapons. It is unlikely that the Japanese Government would accede to these demands. If it did, any nuclear weapons program undertaken in these circumstances would probably be a relatively limited one, designed more for prestige than to meet overall defense requirements. It would not be intended to supplant Japanese reliance on the US for strategic security.

14. The Japanese might consider the acquisition of a nuclear capability if concern over Communist military strength in East Asia were to become much greater than at present. This situation could result from an unexpectedly rapid and extensive missile deployment by the Chinese, coupled with the adoption of a policy of nuclear blackmail by a self-confident Peking regime. It might also stem from a Sino-Soviet rapprochement (admittedly most unlikely at this stage) which appeared to include renewed cooperation between their military forces.

15. In calculating their course of action under such circumstances, Japanese leaders would be acutely sensitive to any evidence of a weakening in US determination to defend the area. This applies both to the maintenance of US forces in the northern Pacific and to the credibility of US nuclear protection. If such evidence appeared, the Japanese would probably feel compelled to review their entire security position. Neutralist alternatives might be considered. An unarmed neutralism would almost certainly be rejected; the Japanese leadership recognizes the perils, consequently the impracticality, of unarmed neutrality in

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the volatile East Asian environment. Neutralism founded on a strong, nuclear-armed, and independent Japanese military establishment would have greater appeal, but we believe that this alternative would only be adopted as a last resort. Japan's leaders would appreciate the severe domestic political and economic problems involved in providing entirely for their own defense: vastly increased military expenditures, crossing of the nuclear weapons threshold, conscription and, possibly, amendment of the "no war" constitution. In overseas relations too, it is recognized that a military buildup of the required proportions would be detrimental to Japan's longer range interests, causing mistrust among the non-Communist nations of East Asia and sharpening the hostility of the Communist states. We believe, therefore, that in the face of an enlarged Soviet or Chinese Communist military threat, Japan would probably seek reaffirmation of US security commitments. Meanwhile, acting with prudence, Japan would accelerate the buildup of its own conventional forces and perhaps initiate a limited or shared nuclear weapons program.

16. Alternatively, should the Chinese Communist threat appear to diminish, Japanese interest in nuclear weapons would probably lag and many might be attracted by the idea of reducing or cutting "unnecessary" defense ties with the US. They might see this as conducive to gaining an influential and profitable role for Japan in China's struggle toward political and economic maturity. In our view, however, such reasoning would probably not prevail in Japanese Government circles. Tokyo would certainly wish to exploit fully any commercial opportunities on the mainland and to improve political relations. If circumstances were favorable, the Japanese would also try to promote a US-Chinese rapprochement. In any event, however, the Japanese would not wish to damage the established and highly advantageous political and economic relationship with the US. This relationship, in which the US consistently accounts for some 30 percent of Japan's trade, may be as compelling as its security requirements in guaranteeing Japan's continued desire to align itself with the US.

17. Certain economic contingencies may be of vital importance in the context of the US-Japanese security relationship. A major return to protectionism in US trade policy would greatly upset the Japanese. While it might not have a critical impact on the Japanese economy, there would be strong resentment against the US which might lead to a loosening in political ties. Simultaneous protectionist trends in Western Europe would further strengthen the arguments of those calling for a reassessment of Japan's Free World alignment. A severe depression in the US or Western Europe could lead to an economic crisis in Japan and, in turn, to increased political strength for extremists of both left and right.

C. Japan in Asia

18. China is, of course, the central problem for Japan in Asia. Japan is concerned to contain China's influence within its present limits. But as indicated above, Japan will rely mainly on US military power to give effect to the military aspects of this policy of containment. We do not envision a Japanese commitment of land forces to a conflict which might develop in Northeast Asia within

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the next five years or so. However, it is possible that Japanese air and sea units would accept a measure of responsibility for the defense of lines of communication in and around Japan, Okinawa, South Korea, and perhaps Taiwan.

19. In the prevailing Japanese view, prospects for peace in Asia can best be advanced by avoiding provocation of Communist China while promoting trade and other contacts. There are other, more direct Japanese approaches to the China problem. Japan has become, and almost certainly hopes to remain, China's leading trading partner (although China accounts for only about three percent of Japan's total trade). While the profit motive is predominant in Japanese business circles, some Japanese leaders view economic interchange with Communist China as a contribution to the "pacification" of Peking. In time, it is hoped, China will abandon its unmitigated hostility toward the outside world and adopt more realistic attitudes on the pattern of the USSR. And certainly, if Peking should adopt a less militant policy and if there appeared to be prospects for a significant expansion of trade, pressure in Japan for the establishment of full relations with Peking would increase.

20. At the same time, Japan sees China as a probable long-range competitor throughout East Asia and is taking advantage of China's current infirmities to entrench itself in the markets of this region, hoping thereby to diminish China's political as well as its economic prospects. It seems clear that some Japanese leaders view their nation as uniquely qualified to provide the sort of leadership which the underdeveloped nations of East and Southeast Asia require to attain economic and political stability.

21. *South Korea and Taiwan* are strategically and historically of overriding importance to Japan. In each case, Japan has overtaken the US as leading trading partner, and will probably take the lead as a provider of economic assistance in a few years. In the ROK, Japan already exerts some covert influence on behalf of political elements favorable to its commercial interests. In official channels, there are bilateral working arrangements in matters of defense, intelligence, and internal security. These ties will grow, although traditional Korean distrust of the Japanese will compel both governments to move cautiously. In Taiwan, the situation is roughly similar, with close personal relationships helping to smooth the way toward establishment of a special position for the Japanese.

22. Japan's interests in the more distant lands of *Southeast Asia* are less compelling. Trade is important; Japan ranks at or near the top as a trading partner in every country. But this trade amounts to only about 10 percent of Japan's total, and there is widespread awareness in Japan that Southeast Asia is not central to the nation's prosperity. Continued rapid expansion of Japanese trade requires developed markets, and Southeast Asia with its low purchasing power is unlikely to become of great importance to the Japanese economy for many years. Moreover, the raw materials production of Southeast Asia is increasingly inadequate to Japan's industrial needs.

23. Japan's political interest in the area is likely to grow, even if its economic involvements remain relatively moderate. Developments in Southeast Asia will

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probably offer broad opportunities to exert political influence, both in regional affairs and within specific countries. Nevertheless, Japan's most likely course for the next few years will be to continue its present emphasis on bilateral and multilateral economic aid, while moving slowly in the political field to apply its influence in support of stability and regional cooperation. Security in the region will still be viewed as primarily the responsibility of the US. There will also be an unwillingness to become deeply involved in the region's political turbulence lest such activity reawaken fears of Japanese domination, prejudice commercial interests in the area, and mar Japan's political prestige on the world scene.

24. Among the countries of Southeast Asia, *Indonesia* may offer the greatest attraction to Japan. It is the largest, most strategically situated, and richest in resources of the countries in the region. It is also actively encouraging foreign investment. In addition, neither the US nor any Western European nation yet holds the inside political and economic track in Djakarta. It remains politically unstable, however, and a long-term petitioner for foreign assistance. Japan will be willing to continue, along with the US, as a major provider of economic assistance to Indonesia. The Japanese are still reluctant to commit themselves to an influential role in Indonesia's internal and external affairs, but this reluctance may diminish in time.

25. *Vietnam* will remain an area of acute Japanese concern at least until the situation there is resolved. Although Japan has no intention of becoming militarily involved, the government should not have difficulty withstanding press and opposition criticism of its support for US policy (so long as the situation there does not change radically for the worse) and will continue to attempt to play a role in promoting negotiations. As an ultimate solution, Japan would probably support neutralization of the Indochina area, coupled with provisions designed to prevent a recurrence of the war. Japan might be willing to participate in truce supervision in a nonmilitary capacity and is prepared to assist in postwar reconstruction both in the South and North.

26. Further afield, in the subcontinent—*India, Pakistan, and Ceylon*—Japanese interests are likely to remain strictly economic. This might change in the event of a greatly heightened Chinese military threat throughout East Asia, which would tend to draw Japan toward some sort of modest cooperation with India. Even in this instance, it is unlikely that the Japanese would seek any close political or security alignment with the Indians, whom they tend to view as relatively impotent militarily, disorganized politically, and economically unpromising. There is, in addition, no important body of thought in Japan which deems the subcontinent relevant to Japan's security position.

D. The "Pacific Community"

27. Japan's most vital economic interests are focused in North America and the western Pacific. The US is overwhelmingly Japan's most important trading partner. Far behind, but in second place, is Australia. Canada is third. In

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total, these three countries supply 40 percent of Japan's imports, and purchase only a slightly smaller proportion of its exports. Trade with Australia and New Zealand could increase significantly if Britain enters the European Common Market and Commonwealth nations lose their preferential trade arrangements with the UK. Awareness is also growing in Japan of the untapped raw material potential in Australia, Canada, and, most recently, Alaska. These economic prospects, as well as an increased similarity of political interests, have aroused Japanese interest in the development of a community of advanced Pacific nations—the US, Canada, Australia, New Zealand, and Japan.

28. Though still vague in concept, this grouping of politically stable areas connected by safe lines of communication is viewed by some Japanese as a counterweight to the EEC and other Atlantic Community economic organizations, which Japan fears may ultimately work to its economic disadvantage.⁴ The Japanese also regard this concept as a useful device in countering any isolationist trends that might grow in the US. Moreover, the Japanese policy-makers see the grouping as useful in assuring the participation of the several wealthy Pacific nations in the task of furnishing economic aid to Southeast Asia.

29. The Japanese will probably devote important diplomatic efforts over the next 5 or 10 years to the cementing of friendly relationships with these countries, though they will probably not press, in the short run, for a formal political organization of the community. We also doubt that Japan will seek a formal security pact within this community, as the US-Japan Security Treaty and the ANZUS pact are sufficient from the Japanese viewpoint.

E. Elsewhere in the World

30. Japan has little interest in exerting influence in the political affairs of such relatively remote areas as *Latin America, the Middle East, and Africa*. We do not foresee any real change in this attitude for some time to come. There is an unwillingness to risk antagonizing potential customers and suppliers by taking sides in any dispute not directly affecting Japan's security. These regions together account for only about 18 percent of Japanese trade and are not of critical economic importance, with the notable exception of the Persian Gulf, which supplies some 90 percent of Japan's crude petroleum imports.

31. *Europe* is of increasing economic importance to Japan because of its potential as an export market and source of capital. Relations with Europe are strongly influenced by Japan's desire to be recognized as a full member of the "club" of advanced industrial nations.

⁴ The basis of the Pacific community already exists to some degree in prevailing trade and investment patterns. Japan's top three trading partners, as noted above, are the US, Australia, and Canada. Japan ranks as second among US trading partners, third among those of Canada, and fourth for New Zealand.

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32. *The USSR.* With both sides agreed on the advantages of peaceful relations, the Japanese-Soviet detente seems likely to continue over the next five years. Over the longer run, however, the range of rapprochement is limited on the Japanese side by the conservative Japanese leadership's antipathy toward communism and its continuing mistrust of Soviet intentions in East Asia, and on the Soviet side by opposition to any expansion of Japan's role in Asia which tended to further the Western orientation of nations in the area. Other irritants which will continue to inhibit closer relations are Japanese territorial claims against the Soviet Union, Japanese support for US policy and operations in Southeast Asia, and the continuing Soviet propensity to involve themselves in what the Japanese construe as Japan's internal affairs.

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ANNEX

JAPAN'S TRADE, 1966 *- 1055*
(In millions of dollars)

COUNTRY OR AREA	EXPORTS (FOB)	IMPORTS (CIF)	TOTAL TRADE	
			Percent	
WORLD TOTAL	9,776 <i>1247</i>	9,523 <i>14,087</i>	19,299 (100.0)	<i>1,513</i>
North America	3,503 <i>4,231</i>	3,444 <i>4,138</i>	6,947 (36.0)	<i>9,329</i>
US	2,969 <i>9,126</i>	2,658 <i>2,527</i>	5,627 (29.2)	<i>7,612</i> <i>(22.2)</i>
Canada	236	451	707	
Mexico	50	178	228	
Other	228	157	385	
South America	279 <i>345</i>	446 <i>512</i>	725 (3.8)	<i>952</i>
Africa	729 <i>940</i>	420 <i>829</i>	1,149 (6.0)	<i>1,769</i>
South Africa	127 <i>170</i>	133 <i>282</i>	260	<i>554</i>
Other	602	287	889	
Europe	1,575 <i>1,516</i>	1,216 <i>1,576</i>	2,791 (14.4)	<i>3,774</i>
USSR	214	300	514	
Other Communist	99	50	149	
West Germany	247	237	484	
UK	235	214	439	
Other Non-Communist	790	415	1,205	
Southwest Asia	332	1,213	1,545 (8.0)	
Iran	72	362	434	
Other Persian Gulf	171 <i>200</i>	821 <i>517</i>	992	<i>241</i>
Other	89	30	119	
South Asia	308 <i>227</i>	248 <i>274</i>	556 (2.9)	
India	167	206	373	
Pakistan	100	31	131	
Other	41	11	52	
Australasia	399 <i>222</i>	832 <i>1,115</i>	1,231 (6.4)	
Australia	258	680	938	
New Zealand	59	113	172	
Pacific Islands	42	39	81	

Footnotes are at end of table.

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JAPAN'S TRADE, 1966 (Continued) - 1966
(In millions of dollars)

COUNTRY OR AREA	EXPORTS (FOB)	IMPORTS (CIF)	TOTAL TRADE
			Percent
Southeast Asia	1,139 125	1,029 112	2,168 (11.2)
North Vietnam	8	10	16
South Vietnam	138	5	143
Laos	3	*	3
Cambodia	12	7	19
Thailand	301 30	153 147	454 512
Burma	47 39	15 12	62 57
Malaysia	89 102	307 343	396 447
Singapore	143	30	173
Philippines	278	325 398	603 399
Indonesia	119 145	176 257	295 397
Other	3	*	3
Northeast Asia	1,510	674	2,184 (11.3)
Ryukyus	230 166	79 87	309 253
South Korea	335 652	72 101	407 753
Taiwan	255	147 150	402 671
Hong Kong	370 447	47 54	417 501
Communist China	315 322	308 224	621 546
North Korea	5	23	28
Mongolia	*	*	*

Source: Japan. Ministry of Finance, Customs Bureau.

* Less than \$1 million.

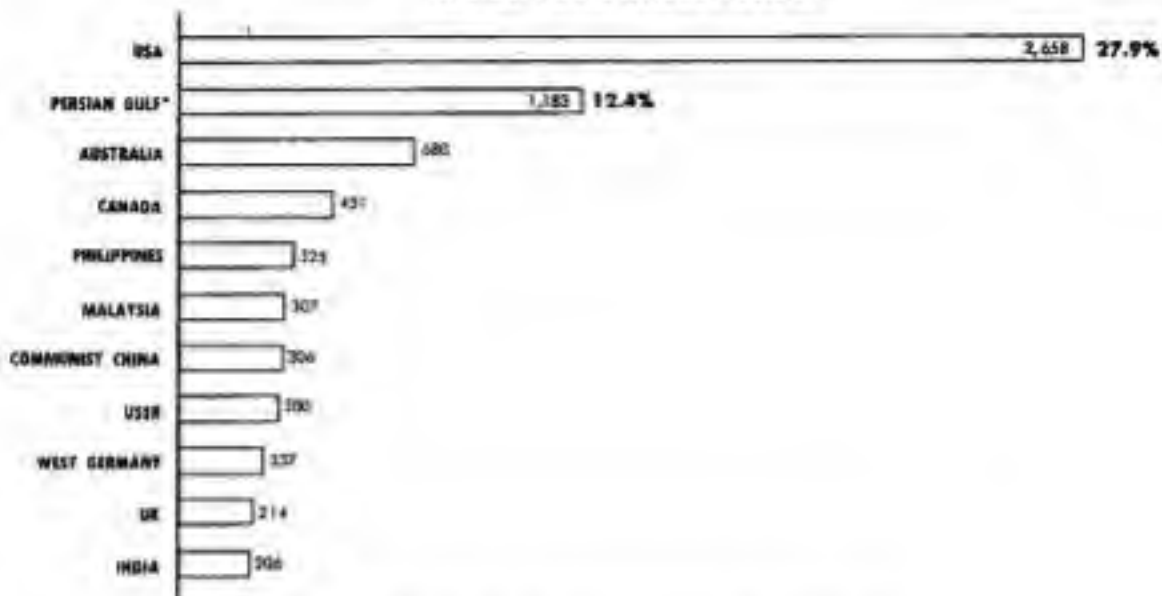
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JAPAN'S MAJOR SUPPLIERS, 1966

(in millions of dollars)

WORLD TOTAL \$9,523 (100.0%)



*Includes Iran (192), Kuwait (192), Saudi Arabia (192), Qatar (192), Oman (192), Bahrain (192), Brunei (192), and Malaysia (192).
*Includes USSR (192), Poland (192), Czechoslovakia (192), Rumania (192), Bulgaria (192), Hungary (192), and Yugoslavia (192).

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JAPAN'S MAJOR MARKETS, 1966

(in millions of dollars)

WORLD TOTAL \$9,776 (100.0%)



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DIST 14 NOVEMBER 1968 (C)

COUNTRY JAPAN RYUKYU ISLANDS

EO 12958
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SUBJ

CONCLUSION OF PRIME MINISTER'S COMMITTEE THAT NUCLEAR
BASES ON OKINAWA NOT MILITARILY NECESSARY FOR UNITED
STATES DEFENSE IN THE FAR EAST

APPROVED FOR RELEASE
DATE: APR 2001

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SOURCE

EO 12958
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1. BY EARLY NOVEMBER 1968 PRIME MINISTER SATO EISAKU'S QUASI-OFFICIAL COMMITTEE ON OKINAWA HAD REVIEWED THE PROBLEM OF AMERICAN MILITARY BASES ON OKINAWA AND HAD CONCLUDED IT WAS NOT NECESSARY, FROM THE STANDPOINT OF MILITARY STRATEGY, FOR THE UNITED STATES TO MAINTAIN "NUCLEAR" BASES ON OKINAWA. THE FINDINGS OF

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"BASES SUB-COMMITTEE", UNDER FORMER JAPANESE NAVY CAPTAIN KUSUMI TADAO, WEIGHED HEAVILY IN THIS DECISION.

[REDACTED] AS CHAIRMAN OF THIS UNIT, WHICH IS ONE OF THE TWO SUB-COMMITTEES, KUSUMI IS INFLUENTIAL IN THE COMMITTEE'S ACTIVITY.) THE COMMITTEE BELIEVES, THEREFORE, THAT EARLY REVERSION OF OKINAWA TO JAPAN, WITH AMERICAN RIGHTS TO BASES UNDER THE SAME CONDITIONS AS NOW APPLY TO THOSE IN JAPAN, IS NOT ONLY DESIRABLE POLITICALLY, BUT MILITAR... FEASIBLE FROM THE STANDPOINT OF JOINT JAPAN-AMERICAN DEFENSE NEEDS.

2. MOST OF THE MEMBERS OF THE COMMITTEE WERE ALSO PLEASED WITH THIS CONCLUSION BECAUSE THEY ARE CONVINCED THAT UNLESS OKINAWA IS RETURNED TO JAPANESE SOVEREIGNTY AT AN EARLY DATE, THE EFFECT OF A DELAY IS LIKELY TO BE "DISASTROUS" ON JAPAN-AMERICAN RELATIONS. [REDACTED] THE GROWING NATIONAL "SELF-CONSCIOUSNESS" AMONG JAPANESE IS A PRINCIPAL, AND USUALLY OVERLOOKED, FACTOR STIMULATING THIS DEMAND FOR REVERSION, AS WELL AS LEFTIST AGITATION.) THEY FEEL IT IS INCREASINGLY DIFFICULT TO FORESEE ALL THE UNFAVORABLE CONSEQUENCES OR THINK OF HOW THESE CONSEQUENCES MIGHT BE FORESTALLED. MOST OF

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PAGE 3 OF 4 PAGES

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THE COMMITTEE MEMBERS, WHO REALIZE THAT JAPAN NEEDS THE UNITED STATES AS MUCH OR MORE THAN THE UNITED STATES NEEDS JAPAN, ARE WORRIED ABOUT THE OKINAWA PROBLEM. THEY BELIEVE THAT, IF THIS PROBLEM REMAINS UNSETTLED, IT COULD POLARIZE PUBLIC SENTIMENT IN JAPAN SO STRONGLY AGAINST THE UNITED STATES THAT EVEN AUTOMATIC RENEWAL OF THE SECURITY TREATY IN 1978 COULD BE JEOPARDIZED. THEY FEEL THAT AT A MINIMUM THIS PROBLEM WOULD STIMULATE GREATER AND MORE WIDESPREAD OPPOSITION TO THE UNITED STATES MILITARY PRESENCE IN JAPAN. [REDACTED] THE COMMITTEE'S CONCLUSIONS ON NUCLEAR BASES HAVE BEEN MADE KNOWN TO PRIME MINISTER SATO, AND THEY PROBABLY WILL CARRY GREAT WEIGHT, BUT SATO'S REACTION IN TERMS OF FORMING ANY NEW POLICY ON OKINAWA REVERSION IS NOT KNOWN. THE RESULTS OF THE OKINAWAN ELECTION WILL INTENSIFY PRESSURE ON THE PRIME MINISTER TO PUSH BOTH FOR EARLY REVERSION AND FOR LIMITED BASE RIGHTS. IN EFFECT THERE IS NO CHOICE FOR EITHER THE PRIME MINISTER OR THE UNITED STATES, SINCE SHOULD THE UNITED STATES MAINTAIN A RIGID POSTURE ON THE NUCLEAR BASE QUESTION, IT WOULD RISK LOSING JAPAN AS A COOPERATIVE PARTNER IN DEFENSE MATTERS.)

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DIRECTORATE OF
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Komeito Seeks the Middle Road in Japanese Politics

Special Report
WEEKLY REVIEW

~~Secret~~

Nº 1

15 November 1968
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KOMEITO SEEKS THE MIDDLE ROAD IN JAPANESE POLITICS

In the four years since its formation, the Komeito--Clean Government Party--has become a significant force in Japanese politics. As the political arm of the militant Soka Gakkai Buddhist lay organization, the Komeito has enlarged upon earlier successes of its predecessor, the more informally organized Koseiren, by winning representation in the Japanese Diet. Following its success in the House of Councilors election in July 1968, the Komeito plans to run 75 candidates in the next Lower House election which could be held sometime next year. The other political parties, which in the past have tended to view the Komeito and Soka Gakkai as a temporary fringe element on the Japanese political scene, are increasingly concerned over the growing strength of the Komeito.

In recent months the Komeito has exhibited a gradual movement to the left in both tactics and policy, resulting in positions which are in conflict with US interests. The Komeito is now demanding that the US-Japan Mutual Security Treaty be phased out during "the 1970s," and that Japan's ties with Communist China be expanded substantially.

At this stage in its development, the Komeito is at a crossroads. To become a truly major force in Japanese politics, it must break out of its close embrace with the Soka Gakkai and broaden its appeal among such diverse elements as labor, the press, small business interests, and the rural populace. Should it be successful, the Komeito has an excellent opportunity in the coming years to fill the growing void in Japanese politics between the ruling conservative party and parties of the left which are becoming increasingly displaced from the mainstream of Japan's political life.

The Komeito, established by the Soka Gakkai in November 1964, succeeded the Koseiren, which ran candidates in local elections and for the Upper House of the

Diet. The Komeito inherited from the Koseiren 15 seats in the Upper House and over 1,000 seats in local assemblies. The Soka Gakkai sought to expand its

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political influence by running Komeito candidates for the Lower House, where the real legislative power in Japan lies.

The decision of the Soka Gakkai to enlarge the scope of its participation in Japanese politics was partly motivated by a need to keep its membership growing, as well as a desire to hold the interest of the members it already had. Another important motivation clearly was the Soka Gakkai's wish to establish a mechanism through which its potentially great, but heretofore diffuse, influence could be channeled into practical politics. The Soka Gakkai probably also wanted to broaden its base of financial support by attracting small businessmen and others interested in securing the patronage of its followers.

Leadership

The Komeito owes much of its success to its young and able leadership. In this respect it has a distinct edge over the Japan Socialist Party, the largest opposition party, which has been handicapped by its predominantly older, less flexible leaders. The leaders of the Komeito generally advanced to their present positions on the basis of their proselytizing and organizational talents. Most are dedicated believers in the Soka Gakkai and in Nichiren Buddhism, but are not so dogmatic that they are insensitive to changes in the Japanese political climate.

The leadership of the Komeito also differs from that of the Socialists and of the other major parties in that it does not visibly suffer from factionalism. The unity of the Komeito leaders has, in large part, accounted for the party's ability to adjust its policies to what the leadership sees as shifts in Japanese public opinion. The Socialists, on the other hand, have generally been unable to develop new policies because of a constant paralysis of leadership brought about by endemic factionalism. Thus, the Japan Socialist Party has remained bogged down by intraparty bickering while the Komeito has moved forward with considerable élan.

Domestic and Foreign
Policy Lines

The ideological framework in which Komeito objectives are cast is broadly derived from that of the Soka Gakkai. The ultimate aim of the Soka Gakkai is the establishment of a "parliamentary democracy in which every individual has been awakened to the principles of Buddhism," as part of a new "third world." This "third world" is to be based on a vaguely defined "neo-socialism" which will promote the welfare of the entire people rather than just the working class. The Komeito and the Soka Gakkai place considerable emphasis on the fulfillment of material desires during a person's own lifetime, rather than sacrificing in this world in

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order to be rewarded in the hereafter. A philosophy of this nature has an obvious appeal to those elements of Japanese society which have not fully shared in the prosperity of postwar Japan.

In the realm of practical politics, Komeito policies generally reflect trends in public opinion rather than the doctrines of Nichiren Buddhism. The Komeito has attempted to find the broadest possible consensus among Japanese on each issue and has then fashioned the Komeito position accordingly.

The Komeito effort to align policy with public opinion accounts in large part for occasionally abrupt tactical shifts on such issues as the reversion of Okinawa. During the mid-1960s, Komeito policy stressed Okinawa's strategic importance and the complex nature of the reversion problem. In August 1967, however, the Komeito demanded the "immediate and complete" reversion of Okinawa as well as the immediate removal of all US nuclear bases and most conventional bases there. The Komeito no doubt believed that this new position would appeal to many more Japanese than the earlier, more moderate position.

Since the formation of the Komeito, its political orientation, at least in tactical terms, has gradually moved toward the left. The shift has come from conscious efforts by party leaders to attract broader electoral sup-

port, primarily at the expense of the Socialists.

The Komeito's line on economic matters is aimed at the left as well as at disenchanted supporters of the Liberal Democrats. The party has called for a comprehensive welfare state, involving a substantial redistribution of income, and the nationalization of certain, as yet undesignated "key" industries.

The foreign policy of the Komeito is based on the rather vague concept of "complete neutrality." Related to this is the party's hardening position on the Mutual Security Treaty with the US. Until recently the Komeito considered the treaty the best arrangement under existing conditions but opposed it in theory. Now it is demanding that the treaty be phased out in three stages during "the 1970s." The Komeito maintains that the treaty subordinates Japan to the US, that it exacerbates tensions in Asia, and that it may involve Japan in a war against its will.

Komeito foreign policy has not wavered so much on certain basic issues, such as opposition to the war in Vietnam and advocacy of increased exchanges with Communist China. The Komeito insists that Japan, because of its importance in East Asia, should play a greater role in easing tension between China and the US. Although it recognizes the potential nuclear threat to Japan posed by China, the Komeito

claims that Japan itself will be isolated if it continues to follow the US policy of isolating China. The Komeito advocates that Japan recognize China immediately, that China be admitted to the UN, and that Japan's commercial ties with China be expanded. This pragmatic position is characteristically attuned to views long held by the Japanese "man in the street."

The Komeito's leftward shift may be more tactical than fundamental. The essentially conservative nature of the leadership seems to indicate that the current tactics represent political opportunism more than firm convictions of the Komeito leaders. Furthermore, much of the party's financial support comes from small businessmen and shopkeepers, who are among the most conservative elements in Japanese society.

Tactics

With the Komeito's swing toward the left, it has shown an increasing willingness to cooperate with the Socialists and the Japan Communist Party in the Diet to further Komeito's interests. The Komeito has, however, repeatedly stressed that this parliamentary cooperation does not indicate approval of Socialist and Communist ideologies. Cooperation has been, and likely will continue to be, on an issue by issue basis. Particularly in the case of the Communists, there is considerable ill will between the parties because they often compete for support from the same

proletarian elements in Japanese society.

The Komeito is relying more and more on the street protest rally as a political tactic. The highly disciplined Komeito has shown several times recently that it can quickly and effectively mobilize supporters for demonstrations. It could probably mobilize 200,000 to 400,000 supporters virtually overnight for an important issue such as agitation for review of the Mutual Security Treaty in 1970. The Liberal Democrats clearly respect this capability of the Komeito, and can be expected to avoid action on matters which could arouse strong Komeito opposition.

The Komeito's political methods are becoming increasingly sophisticated. There now is less of a tendency to resort to blatantly unethical campaign methods, and a greater reliance on Komeito mobilization skills, both in the street and in the polling booth. Because of the high degree of discipline of Komeito supporters, the party boasts the most efficient use of votes of any political party in Japan. Komeito discipline has also enabled the party to persuade followers to move to areas of weak electoral strength in support of a Komeito candidate, even when they had to find new jobs and homes.

Sources of Support

Komeito still draws its support largely from the ranks of the Soka Gakkai, whose membership

comprises primarily members of the lower and lower-middle classes clustered in urban areas. Japanese of strongly nationalistic sentiment are also attracted to the Komeito because of its stress on Japanese ways.

The Komeito is now making plans to expand its support in the Japanese labor movement, where its influence traditionally has been weak. The Komeito announced last year that it would form a new labor union--to be called the Democratic Labor Council--after the next Upper House elections. According to a recent policy statement, a preparatory body will be set up late in 1968, and the labor union itself will be organized sometime next year.

The Komeito labor organization will be aimed primarily at workers in small- and medium-sized enterprises. The potential for Komeito growth in this area is clearly indicated by a recent Ministry of Labor survey, which revealed that two thirds of the nearly 30 million employed workers in Japan do not belong to labor unions. The majority of these workers are employed in small- and medium-sized enterprises.

The early formation of a Komeito-sponsored labor union would be opportune because of the fluid situation in the Japanese labor movement. The influence of Sohyo, the major labor organization, has declined recently, as has its membership. Furthermore, the percentage of

union members in the total number of employed workers in Japan has also been declining. The Komeito leadership is projecting a "gradual growth" for the new union during the first four or five years.

Domestic Political Significance

Unencumbered by an outmoded and inflexible ideology, the Komeito may be in a better position to reflect the general consensus on particular issues than any of the other opposition parties, particularly the Socialists and the Communists. The Komeito thus appears to be in a position to fill a great need in Japanese politics--a relatively middle-of-the-road opposition party which is attuned to the views of the broad masses of Japanese. If the Komeito is to fill this role, it will, however, have to undergo an extended period of substantial change and growth.

There are several major impediments to the growth of the Komeito, but according to tentative indications, the Komeito is beginning to overcome many of them. Its most serious liability is a relatively narrow base of support. The Komeito's heavy dependence on Soka Gakkai members is becoming an increasing handicap because the growth of the Soka Gakkai has been losing momentum. Although the Komeito has made significant gains in recent elections in terms of seats won, the percentage increase in the size of its vote has begun to fall off--especially

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at the local level. The decision to form a labor union in part may have reflected concern over the slackening rate of growth.

There has been some recent evidence, however, that the Komeito's base of support is now expanding beyond the Soka Gakkai. According to Komeito claims, in the Upper House election last July the Komeito vote in some areas was more than double the number of Soka Gakkai voters in those areas. In Kobe, for example, the Komeito claims to have received 400,000 votes although there were only 170,000 eligible Soka Gakkai voters. Although Komeito claims must be treated with caution, it appears that the Komeito has successfully extended its appeal to non-Soka Gakkai members on a modest but significant scale.

There is some indication that Komeito support in rural areas is also increasing. Komeito leaders point to the party's growing electoral strength in such areas as Fukuoka. Party representatives have visited other rural areas to investigate ways to expand Komeito support among non-Soka Gakkai members. The Komeito reportedly is considering increasing its grass-roots support in small villages by expanding Soka Gakkai mechanisms for transmitting complaints of villagers upward from the village level.

In urban areas, the Komeito support from among non-Soka

Gakkai elements could snowball rapidly if there were a sudden deterioration in the political or economic situation in Japan. Even without radical change for the worse, the Komeito seems assured of at least moderate growth during the next few years because of the continuing rapid urbanization of Japanese society. The constant migration of rural Japanese to the cities guarantees a continuing influx of insecure and maladjusted people to replace earlier arrivals who move up the socioeconomic ladder.

Another factor which may, however, inhibit Komeito expansion, particularly into the Japanese labor movement, is the opposition that the Komeito's planned labor union will draw from the other major labor unions, already apprehensive about the threatened Komeito expansion into their domains. As yet the major labor organizations, particularly Sohyo, have publicly ignored the Komeito's plans. Sohyo, concerned about its declining numbers, is, however, now eyeing the large numbers of unorganized workers in small- and medium-sized enterprises--also the prime focus of Komeito attention.

The failure of the Komeito to win the support of any significant segment of the Japanese labor union movement thus far has deprived the Komeito of one of the traditionally important core elements of a Japanese opposition party. This deficiency, in combination with the failure of the Komeito to attract

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support from the mass media and the intellectuals, also traditionally important core elements of the political opposition, limits the ability of the Komeito to function as a modern political party.

The Komeito may be able to compensate partially for the lack of allegiance from established labor union leaders by creating its own labor union. There is also evidence of a growing respect for the Komeito in the Japanese mass media, particularly since the recent Upper House election. Japanese intellectuals, as well as many middle-class Japanese, tend to view the Soka Gakkai and the Komeito as a fanatical religious organization. Although the Komeito is gradually gaining respectability as a result of its efforts to mirror the widest range of Japanese public opinion, many Japanese still identify its aims very closely with those of the Soka Gakkai. The Komeito will have to disassociate itself from this image if it is to attract the support of the elements of Japanese society necessary for it to function as an effective opposition party.

The Komeito's growing difficulty in maintaining iron discipline among the rank and file as the party membership expands may also affect its future success. Many of the younger recruits to the party's ranks tend to lose interest quickly. Discipline may also be weakened if the Komeito sacrifices organizational

cohesiveness and single-minded dedication to Nichiren Buddhism in order to broaden the party's appeal. Thus, the Komeito leadership is faced with a decision which can fundamentally alter the present character and direction of the party.

Government Party Concerned

The Liberal Democratic Party apparently is anticipating significant Komeito growth; Liberal Democratic leaders recently have privately expressed concern over Komeito prospects in the next Lower House elections. Preliminary Liberal Democratic estimates predict a possible loss of ten seats to the Komeito. Liberal Democratic Secretary General Fukuda recently commented that his party might have to put off elections until 1970 in order to develop more effective counter-measures against the Komeito's expanded electoral efforts. Fukuda's comment undoubtedly reflects the increased awareness of Japanese political observers of the political significance of the Komeito following the Upper House elections last July and the Komeito's subsequent announcement that 75 candidates would be entered in the next Lower House elections. The earlier tendency of the Japanese "establishment" to underestimate the strength of the Komeito has been subjected to serious re-examination, resulting in what in many cases are probably inflated estimates of the Komeito's growth potential. (CONFIDENTIAL NO FOREIGN DISSEM)

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Japan in the Seventies: The Problem of National Power

Submitted by

Richard Helms

DIRECTOR OF CENTRAL INTELLIGENCE

Concurred in by the
UNITED STATES INTELLIGENCE BOARD

As indicated overleaf

25 June 1970

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CONTENTS

	<i>Page</i>
NOTE	1
CONCLUSIONS	1
DISCUSSION	4
I. JAPANESE POLITICS: The State of Play	4
... and the Potential for Change	7
II. ECONOMIC AND SOCIAL ISSUES	9
The Economy	9
Social Issues	13
III. JAPAN'S WORLD ROLE	13
The Pacific Power Balance	15
The "Developed" World	17
East Asia	18
The Role of the Military	19
IV. UNSETTLING CONTINGENCIES	22
V. IN SUM	23

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JAPAN IN THE SEVENTIES: THE PROBLEM OF NATIONAL POWER

NOTE

Prime Minister Sato has said that in the 1970s Japan must face the "problem of national power"—a concept which he has defined as the "aggregate of a country's political stability, economic strength, military might, its sway over international opinion, its cultural heritage, and so forth". In this Estimate we look at how these several aspects of Japanese national life are likely to evolve and interact during the decade, and at some of the implications for the US.

CONCLUSIONS

A. Japan enters the 1970s with the world's most dynamic economy, a population proud of its accomplishments, and a moderate government firmly in the political saddle. Its problems during the coming decade will be how to use its riches and growing self-confidence to improve standards of living at home and to find a suitable role for Japan abroad.

B. The chief arena of political competition will continue to be within the Liberal Democratic Party (LDP), and it is here that the most significant new pressures will make themselves felt. In the long run, the LDP can probably maintain its commanding position only if it meets mounting pressure for attention to Japan's social infrastructure needs, especially in the booming cities. In the process, support for the party itself is likely to change markedly from conservative rural constituencies to the urban middle classes.

C. Japan is in a strong position to continue rapid economic growth, although sooner or later a decline from the past average real growth rate of 10 percent a year is likely. But while Japan's strength and in-

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fluence within the international economic complex will continue to increase, so will the dependence of Japan's prosperity on continued access to foreign markets. A prolonged international recession or the imposition of severe foreign trade barriers by Japan's main trading partners would have grave economic repercussions in Japan, all the more so because its economic system is geared to rapid growth.

D. Japan's search for a "world role" will focus initially on gaining international status and recognition through, for instance, an enhanced role in the UN, and on continued efforts to promote Japanese economic interests abroad. By the end of the decade, Japan will be more nearly an equal in its economic relations with the US; is likely to be the dominant external factor in the economic life of non-Communist Asia and the largest external economic influence in China, Australia, and New Zealand; and in all likelihood will be the greatest single economic rival of the US even in such traditional American preserves as Latin America.

E. Politically, economically, and emotionally, Japan is attracted to the developed nations, particularly those of the Pacific Basin—the US, Canada, Australia, and New Zealand. Its economic role in East Asia gives it a major stake in the stability of that region. Its foreign aid to East Asia will increase substantially, accompanied by growing economic and eventually political influence. In Southeast Asia, however, Japan will try to keep its political activity in a multilateral context. Even in Northeast Asia, where Japan will engage in increasing bilateral exchanges on intelligence and internal security with South Korea and Taiwan, it will want to avoid political or security involvement which might provoke North Korea and especially China.

F. All Japan's Asian policies will be fundamentally affected not only by its relations with the US but also by its reading of the balance among the US, USSR, and China. The Japanese think they have an independent "bridge-building" role to play between the Communist and non-Communist powers in Asia. And to some extent they count on mutual antagonism among the three great powers to help Japanese influence with each one. They will be persistent in friendly overtures to China, and reluctant to engage in any activity which could be construed as "anti-Communist".

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G. The Japanese defense related industries will grow substantially over the decade, though the Self-Defense Forces probably will increase only gradually with primary emphasis on air and naval forces. The navy and air force will extend their area of operations, and eventually will come to accept a greater share of responsibility for defense of Japan's vital lines of communications. But Japan will not want to station troops abroad or to accept foreign military commitments, certainly not bilateral ones.

H. We are less certain about Japan's nuclear future. The issue will be the subject of growing national debate, and the decision will be affected not only by Japanese sentiment *per se* but also by US and Chinese policies. On balance, we think that unless the Japanese come to feel some imminent threat to themselves for which US protection is deemed unreliable, they probably will not decide to produce nuclear weapons at least for some years to come.

I. Japan will want the US military presence on its lands reduced and want a greater Japanese voice in the use of the forces which remain. But so long as it is ultimately dependent on American military protection, it will on balance probably want some US military presence on its territory to give force to the American commitment. Economic issues are likely to be a greater source of friction than US military bases. Most important of all, as the decade goes on, Japanese governments will be increasingly eager to demonstrate—to other Asians and to their own electorate—that their policies are independent of Washington's.

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DISCUSSION

1. In the years since World War II, most Japanese have equated "national power" with economic strength. This has been the almost-obsessive national concern; potentially divisive issues—even differences over how to share the wealth—have been largely subordinated to the hard work which has won international respect and restored Japanese pride and self-confidence. And the success of conservative governments in directing this effort has been the key to their domination of Japanese politics since the war.

1. JAPANESE POLITICS: The State of Play . . .

2. The instrument of this domination over the past 15 years has been the *Liberal Democratic Party* (LDP), which won 288 of the Diet's 486 seats in the recent parliamentary election.¹ The LDP still depends on Japan's rural population for the bulk of its votes. But the party's directing Establishment is an amalgam of business and financial leaders, top civil servants, and party professionals. In Japan's unusually homogeneous society, these men share ties of family and school, common outlook, and a strong sense of mutual obligation and loyalties.

3. There also are more practical links. Business leaders bankroll not just the party but individual politicians as well, and keep close, semiofficial contact with the recipients of their favors. In turn the government, through the Bank of Japan, controls the commercial bank loans on which Japanese business depends. The government also regulates—indeed sponsors—company mergers, price fixing, and production and market sharing. The bureaucracy has an unusually large role in shaping and implementing policy, as well as in processing the pork-barrel needs of individual Dietmen. Furthermore, top civil servants often "retire" to business posts and sometimes to political office. And a complex of "Deliberation Councils," including members from the business world, permeates every part of the bureaucracy. These and other ties result in probably the most deftly guided economy in the world—often called "Japan, Inc."—in which individual business ambitions are adjusted to serve the greater good.

¹ RESULTS OF DECEMBER 1969 LOWER HOUSE ELECTION

	SEATS	PREVIOUS STRENGTHS (Seats)
Liberal Democratic Party	288	277
Japan Socialist Party	90	140
Komeito	47	25
Japan Democratic Socialist Party	31	30
Japan Communist Party	14	5
Independent	16	9
TOTAL	486	486

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4. Japanese traditions call for government leaders to perceive and act on the national "consensus," rather than for open contests for votes on issues, as is the theory in Western democracies. This requires that the opposition's views be given (or seem to be given) full consideration however small its vote, that the government avoid any impression of arbitrary action, and even that information elsewhere considered confidential be allowed into the public domain. This means, in effect, that national policy changes only slowly, after persuasion and compromise within the LDP and after public opinion is fully prepared. The substance of the consensus in postwar years has been remarkably constant: first priority to economic growth, low military budgets coupled with close relations with the US in defense and foreign policy, no nuclear weapons in Japan or Japanese troops abroad, and no overt hostility toward China. In recent years this consensus has been affected by growing national awareness of Japan's extraordinary economic strength and a desire to project Japan's image as an independent "big power." These newer aspects have prompted efforts to recover territories occupied by the US and USSR, to scale down US military bases, and to sponsor such prestigious international activities as the Olympic games and Expo-70.

5. The LDP's success in discerning and expressing the national mood has helped to reduce the traditional opposition—the Socialists, Democratic Socialists, and Communists—to a degree of impotence and frustration most extreme in the *Japan Socialist Party (JSP)*. The JSP entered the postwar era with high hopes. But its continued exclusion from power, the rivalries and recriminations within it, and its persistence in a Marxist ideology of ever decreasing relevance to Japan's affluent society, all have contributed to a rot which culminated in the loss of over one-third of its Diet seats—from 140 to 90—in the December 1969 election. Socialist backbenchers in the Diet, and the labor unions on which the JSP depends for money and campaign work, are openly impatient with the party. But they have been unable to move the party leadership. Virtually excluded from decision making, the party has resorted to demonstrations in the streets and physical disruption of the Diet in order to make its views felt. But these tactics of protest against the "tyranny of the majority" have lost the public sympathy they once helped engender for the JSP. Barring a near-miraculous revitalization of its leadership or some major and now unforeseeable political or economic failure on the part of the LDP, the JSP is likely to continue its decline into irrelevancy, or even to suffer serious splits.

8. The much smaller *Democratic Socialist Party (JDSP)* may actually have had more influence on government action over the years, as many of its moderate and pragmatic proposals have subsequently been adopted by the Liberal Democrats. But the JDSP has in the process become a "second conservative party", appealing only to those who want to register a mild opposition to the government. Of all the Japanese parties, the JDSP gained least ~~APPROVED FOR RELEASE~~ ~~DATE NOV 2008~~ in the last elections, increasing its Diet seats only 1. Its poor electoral showings have thus far kept it from attracting those JSP politicians who might be tempted to defect to a more pragmatic socialist party; if the JSP does come apart in the future, the JDSP could of course expect to be a

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major beneficiary. But the JDSP's best hope for a share of power may lie in a possible future LDP need for a coalition partner, rather than in any prospect of itself becoming a major opposition force.

7. The *Japanese Communists* (JCP), on the other hand, have enjoyed something of a revival in recent years. Their remarkable success at the last national election in raising their Diet seats from 5 to 14, and in Tokyo city council elections of a year ago, confirmed the party in its strategy of working to establish itself as a non-violent, national force by demonstrating independence from foreign parties and at least tactical moderation. But most of the new Communist voters were in fact defectors from the JSP, and not new recruits to the left. Moreover, most Japanese are far from accepting the party's new "loveable" image while, on the other flank, it is under attack by radical students for having gone conservative. The JCP can hope, at best, to continue becoming a more respectable party and to have a larger voice in opposition councils. But it is unlikely to acquire a sufficiently "Japanese" image even to lead the opposition, much less to challenge the government.

8. A relatively new phenomenon in Japanese politics is the *Komeito*, or Clean Government Party. Komeito was established in 1964 as the political arm of the rapidly growing Value Creation Society (Soka Gakkai), itself an offshoot of the aggressive Nichiren Buddhist sect. Highly organized, superbly disciplined, virtually faction-free, Komeito is perhaps the first genuine attempt to form a broad-based political party in Japan. Its appeal is pitched primarily to the lower middle classes and the poor who feel uprooted and somehow left behind in Japan's race to new prosperity. The parent religion promises its members temporal gain—business success or marital tranquility or regained health—immediately upon conversion. And Soka Gakkai's enormously successful network of organizations for every conceivable Japanese interest group gives these people an important sense of "belonging".

9. Komeito's own platform is a very pragmatic (its critics say opportunistic) exploitation of the public's growing concern with domestic bread and butter issues. Its stand on social issues, and on the desirability of closer ties with China and more distance from the US, could be called "left". But there also is an element of religious fanaticism in Komeito's appeal, the suggestion of a Japanese mission to save the world from the two "extremes" of Christianity and Marxism, which reminds some critics of the rightist nationalism of the prewar period.

10. Komeito almost doubled its Diet strength—from 25 to 47 seats—in last December's election and, perhaps even more important, got an estimated one-third of its votes from outside Soka Gakkai's membership. But Komeito, too, faces serious obstacles. Its militancy, religious fanaticism, and lower-class image, as well as the charges against it of ultranationalism, limit its appeal in Japan's secular, status-conscious society. As the party tries to distance itself from the religion and deal more specifically with concrete issues, it risks losing the fervor and unity it has thus far enjoyed. And as it strives for respectability, it may find itself moving closer to the LDP on major issues rather than providing a

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new rallying point for potential opposition sentiment. The LDP, with its control of the economy, its access to talent, patronage, and funds, would easily hold the edge in any such contest.

. . . and the Potential for Change

11. Japanese politics is likely to change during the 1970s, and some new directions already are apparent. For one thing, the issues in debate are broadening and becoming more complex. Controversy will grow over how to divide the wealth, cope with Japan's urban and other environmental problems, educate the young, reapportion the Diet, find a world role and cope with Japan's defense problems, perhaps even how to write a made-in-Japan constitution.

12. And there will be more players in the political game. Many of Japan's new urban middle classes seem to be leaving some of their traditional group loyalties back in the village. In social life this tends to greater permissiveness, even a weakening of the Japanese urge for conformity and acceptability. In politics, this may mean voting more discriminatingly on the issues, or at least on a candidate's personal appeal, rather than on a basis of loyalty and obligation to a political boss. And while the Japanese are not yet flocking to become active members of political parties, they are making more use of special interest groups such as consumer associations and the PTA to press their ideas and demands on the government. Insofar as there is an erosion of the strength of paternalistic traditions, in government or in business, the potential for a floating vote will grow.

13. Japanese labor is increasingly interested in greater economic benefits for its members, and less willing either to sacrifice higher wages to company growth or to lend itself to the archaic ideological crusades of Marxist parties. Thus regardless of whether the presently competing labor federations unify or not, the labor movement will probably be a much more conservative factor in Japanese politics even while becoming more aggressive in wage demands. Active labor support for the Socialist Party, in terms of money, votes, and supporting demonstrations, will continue to grow weaker.

14. At present Japan has no "defense establishment" in the American sense. Some large corporations and their subcontractors participate in Japan's equipment procurement programs, but military procurement does not play a major role in Japan's economy or in the profits of individual companies. Nonetheless, some industrialists and political leaders are becoming more outspoken in pushing defense and defense-related industries. The military's influence may be further enhanced by Defense Chief Nakasone's efforts to improve the morale and image of the services. Nakasone also wants to create a permanent Defense Committee in the Diet, and this could become the arena for a "lobby" and for opposition to it. But even with considerable defense-related industries would play a relatively small role in Japan's economy; and certainly the military are not likely to threaten civilian control of the government.

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15. Student protests seem to be losing influence in Japan. Until quite recently, student demonstrations complimented the efforts of leftist parties to disrupt government policies, and police suppression of the students won the left some general sympathy. However, as the level of student violence rose and the police became more skillful in handling it, the mass of students, the general public, and even most leftwing parties came to shun student extremists. The young radicals appear resigned to their isolation and reportedly plan to concentrate more on individual acts of terrorism than on getting large numbers into the streets. At the same time rightist student groups are announcing plans to take on their radical leftist classmates in defense of "traditional Japanese values". Student extremists of whatever political stripe will probably remain a serious nuisance but not a political force if they continue present trends toward terrorism and toward fighting among themselves. But should they abandon the tactics of flagrant violence their influence on public opinion, and particularly on academic opinion, could grow.

* * *

16. The new issues and participants in Japanese politics certainly will offer opportunities to the opposition parties. But Japan remains essentially a conservative society, and the strength of tradition is likely to be just as impressive as the pace of change. Furthermore, the opposition is in poor shape to take advantage of opportunities. Not even Komeito, which has greatest growth potential, seems likely to become a serious threat to the LDP's political dominance. Nor is there any evidence that the opposition parties could cooperate in a united front. Indeed the "multiparty" opposition which emerged from the last election, with no one party able even to pretend to leadership, theoretically gives the LDP a freer hand than ever.

17. Of course there could be political realignments during the decade. But an upheaval great enough to challenge the present Establishment is unlikely in the absence of a major national crisis. This sanguine outlook for the LDP is not an unmixed blessing for Japanese democracy. If those who do stand outside the consensus feel the legal means to influence closed to them, they will be tempted to lash out violently against "the system" as the "new left" does in the West, or to work covertly against it as the Japanese Communists have done in the past.

18. But most Japanese—whether the old Establishment of big business, or the new hopefuls in the military or local interest groups, or possibly even organized labor—are likely to conclude that the way to make their influence felt is through the LDP. At least for the next several years and probably well beyond that, this will be the chief arena of political competition. The LDP itself is likely to change, reflecting the changes in Japanese society and its consensus. The LDP will concentrate less on the dwindling rural population and more on capturing the emerging "floating vote" in the cities and new suburbs.

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DATE: NOV 2008

19. The present LDP leadership is certain to have at least two more years of power beyond next autumn's party elections, when Prime Minister Sato will choose either to have a fourth two-year term as party chief or to name a successor—most likely Finance Minister Fukuda or Party Secretary Tanaka—from

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among the familiar faces. Beyond that, differences over the more complex issues of the 1970s will complicate the old game of personal rivalries and factional horse-trading in contests for party leadership. The issues which will influence these contests can be described as Japanese concern over three groups of questions: How to manage the further development of the economy? How to meet Japan's pressing social infrastructure needs and thus ease the inevitable tensions of a booming, urbanizing society? And how to find a world role which adequately expresses Japan's economic strength and the talents of its people?

II. ECONOMIC AND SOCIAL ISSUES

The Economy

20. The key to any judgment about Japan, perhaps even to the continued moderation and caution of the LDP leadership, is further economic growth. The Japanese economy has expanded at a real average annual rate of 10 percent in the past 15 years—an extraordinary performance by any standard. There have been frequent predictions of an imminent slowdown; but in recent years the rate of growth has accelerated to 13 percent. By comparison the US considers 4 percent a good performance and most West European countries are satisfied with a 5 percent growth rate. The Soviet economy too, in spite of its strong growth orientation, has slowed to about 5 percent.

21. Japan's phenomenal growth rate has been partly due to the fact that it was simply catching up with other major industrial powers. But it has now more than caught up with most of them, and growth still continues at a high rate. Japan now has the world's third largest Gross National Product (GNP), trailing only the US and Soviet Union. Per capita GNP is fast approaching that of the UK and if past rates of growth continue it will reach the present US level before 1980. We still expect a slowdown in Japanese growth sooner or later, perhaps in the second half of the 1970s. But barring a world depression or severely restrictive US import policies we expect growth to be around 10 percent in the next few years.

22. In some respects, Japan is in a better position than in the past to sustain rapid economic expansion. Its improving balance of payments position reached the point in the late 1960s where the country was running almost continuous surpluses. This has given the government greater flexibility in its economic policies, and makes less likely the periodic slowdowns imposed in the past to conserve foreign exchange. The high and still growing standards of education and technical skill of the Japanese people, their increasingly sophisticated sales network across the world, even Japan's reputation as the world's most dynamic economy, all give it a position of great strength from which to operate abroad and have foreign investors clamoring to be let into Japan.

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DATE: NOV 2000

23. The restraints the Japanese economy is beginning to encounter are in part a product of its enormous success in the past. The birth rate has been declining as prosperity has been growing, and now Japan faces labor shortages.

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The labor force is expected to expand at about one percent a year during the 1970s, a good deal slower than the 1.5 percent average annual rate during the 1960s. More Japanese are staying in school longer and wanting better jobs at higher pay when they do go to work, which means employers will have an especially hard time finding enough manual workers.

24. Labor stringencies have put Japanese unions in a strong bargaining position: wages rose by about 18 percent last year and pressure is on for wage increases on the order of 20 percent this year. Consumer prices have been rising on the order of 5 percent a year for the past few years. Until last year, export prices were very stable because the increase in wage costs and in productivity were about equal. But since early 1969, export prices have also risen by about 5 percent, partially because of the higher wage rates.

25. Some of the force behind Japan's growth may diminish in the 1970s. Rising labor costs will continue to push up the price of Japanese exports. While similar inflationary pressures throughout the industrialized world will help keep Japan's competitive position strong, there could be some slowdown in its rate of export growth. Moreover, Japan will no longer have quite so much room for catching up with other industrial powers. Heretofore Japanese labor productivity on the average has been well below that of the US and Western Europe while the level of education of Japanese workers was among the world's highest, thus allowing plenty of room for improvement as sophisticated plant and equipment were introduced. And Japan's industrial technology has lagged behind that of other industrial powers, thus enabling Japan to benefit from research done at other's expense. Both these advantages are diminishing. Labor productivity is nearing West European levels. And acquiring new technology may become more expensive as Japan moves from being a purchaser of US and West European licenses to a position of being a world leader in domestically developed technology.

26. Still, Japan clearly has the resources and institutions to grow rapidly in the 1970s. The government has the control mechanism, and the demonstrated skill, for controlling prices and manipulating resources more easily than most of its trade rivals. The powerful Ministry of International Trade and Industry (MITI), in concert with other government departments, can "advise" the large economic combines to concentrate on those activities with greatest growth potential, and on a rational division of work among them. Thus the industries which have experienced the most phenomenal growth in past years—automobiles, steel, and consumer electronics—probably will grow somewhat more slowly in the future. But at the same time the Japanese will be concentrating on the expansion of their chemical, space, computer, transportation, and nuclear energy industries.

27. The most apparent threat to this rosy prediction is from external Prolonged world recession or the imposition of severe import restrictions in the US could create a serious economic crisis in Japan. The most dynamic Japanese industries are also the most dependent on world markets and it would be diffi-

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DATE: NOV 2008

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cult for them to adjust to a more inward looking economic growth process. Japanese economic institutions, moreover, are adapted to rapid economic growth and lack some of the built-in cushions and stabilizers that take the sharpness out of recessions in other countries. Japanese industry depends overwhelmingly on bank borrowing to finance its growth; its internal savings as well as its profit margins are relatively small. Japanese firms thus can not rest on their laurels; they have to continue expanding rapidly in order to survive. In the past even moderate slowdowns—to five percent or so—caused numerous bankruptcies of smaller firms. The government has been and continues determined to bail out major firms from such contingencies. Nonetheless, should a major and prolonged economic recession develop, the Japanese might be hard put to cope with it without severe political and social strains.

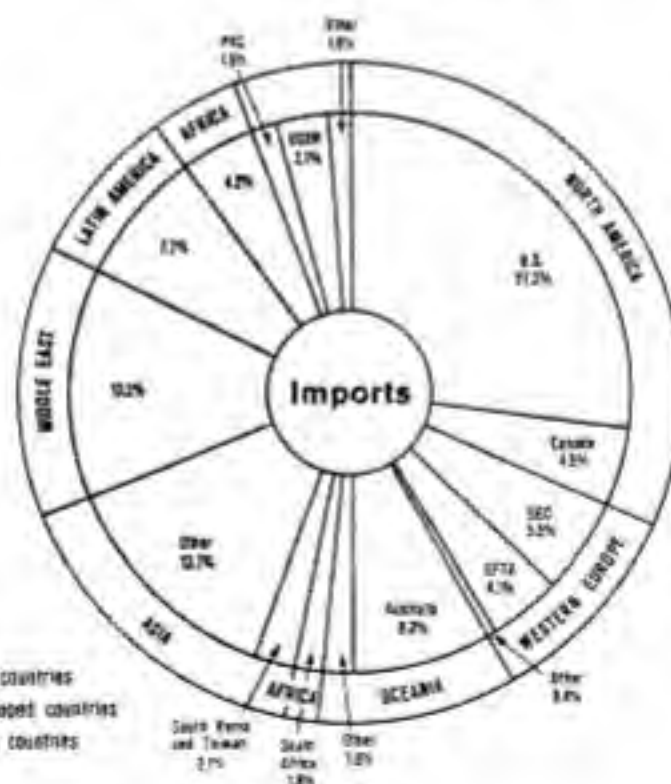
28. Despite resistance, Japan's economy is likely to become more internationalized, rather than more "independent," as the decade goes on. But its strength, influence, and impact upon the international economic complex will continue to grow. For instance, Japan already leads the world in shipbuilding and many consumer electronic products and in the mid-1970s probably will surpass the US in steel production. It also has reached the point of sizeable trade and payments surpluses which are likely to continue for some time. Thus Japan's international economic policies will have an important bearing on the international economic climate.

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Japan: Exports and Imports 1969



- Developed countries
- Less developed countries
- Communist countries

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Social Issues

29. As Japan goes on getting richer, the deficiencies in its social infrastructure become more glaring. This could become the LDP's greatest pitfall. The growing cities get most publicity, and do indeed badly need more houses, hospitals, schools, sewage facilities, and some easing of the appalling traffic congestion and air pollution. But the politically powerful rural areas also need better water supply and roads and more modern farm equipment. And local government authorities are demanding more of the money and authority now jealously guarded by Tokyo so they can cope with specific local problems. These needs have been neglected as most available money was plowed back into industrial growth. Now, Japanese attitudes clearly are changing. While top LDP spokesmen during the last election campaign were pointing with pride to Sato's success in the Okinawa negotiations with Washington, local candidates and the voters were talking about housing and roads and pollution and prices. Sato made these subjects the core of his policy address to the new Diet in February.

30. Japan clearly has the money to deal with these problems, and the Establishment is at least talking about their urgency. Perhaps more important, Japanese traditions of collective action and tight social organization would make a concerted national effort more feasible than in countries more given to individualism and separation of powers. More important even than money may be the time needed to develop new programs. Thus the government's effort almost certainly will not entirely keep up with the public's hopes. If it should fall too far behind, it would hand the opposition the best possible issue on which to mount a major challenge. But we think it more likely that the government will be able to exploit its efforts along these lines as a major source of national pride, a demonstration of LDP responsibility, and grounds for satisfaction with continued LDP rule.

31. The decade will also see further transformation of Japan from a nation of rural-agricultural roots to one permeated by the urban-industrial outlook characteristic of the West. The postwar period of strong official encouragement and support to the family-sized farm unit is approaching its end. It is foundering on costly rice production subsidies, easy availability of urban employment for farm youth, the insatiable demand for residential and industrial acreage, and a growing understanding of the need to rationalize an inefficient sector of the national economy. The LDP appreciates the problem but is caught between its dependence on the declining rural vote and a need to find more funds to meet the challenge of the cities and so ensure support from the increasingly powerful complex of interests centered there. The issue of reapportionment of Diet seats to reflect the realities of population distribution encompasses most facets of this sensitive rural-urban issue.

III. JAPAN'S WORLD ROLE

32. Virtually all discussions of Japan include some reference to reviving "nationalism," but the Japanese themselves are not sure just what this term involves. It appears to combine a reassertion of overt national pride at home

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with a compulsive desire to make the rest of the world notice, appreciate, and respect the Japanese nation and its works. It includes strong if ill-defined longings for a major Japanese voice in world councils and, to the extent feasible, a powerful position in bilateral dealings with other nations. But the practical consequences of such urgings are far from clear. At the very least, Japanese desire for praise and international status will grow. For many, this need is satisfied by such things as the homage Western journals pay to Japan's economic accomplishments. A successful space program or a well-publicized attack on environmental problems could also provide outlets for "nationalist" emotions.

33. The Japanese also place great importance on recently acquired membership in the Eighteen Nation Disarmament Conference and the International Monetary Fund Board of Directors. Japan particularly desires to enhance its role in the UN, which it perceives to be well suited to Japanese aspirations for a big power role without military commitments. Government officials talk of "semipermanent" Security Council membership, perhaps on a rotational basis, or even of permanent membership without a veto power. Either step would doubtless be seen by the Japanese as an interim measure toward eventual full Security Council membership. The Japanese public sees these aspirations as a natural and desirable consequence of Japan's postwar revival. Opposition by foreign powers, particularly the US, could very well be taken as a national affront.

34. Opinion also is united on the need to continue to increase Japan's share of world trade. For the next several years at least, "foreign policy" still will be primarily a matter of economic relations. Japan will continue its search for diversified and reliable sources of raw materials, for expanded markets for its industrial goods, and for opportunities to establish export-oriented plants in nearby countries with an abundance of cheaper labor. Government circles recognize the importance of foreign aid in promoting Japan's commercial interests abroad.² Arguments for more aid will also be supported by the country's large foreign exchange reserves, and the government's resulting desire to fend off international pressure for revaluation of the yen. As a consequence of its extensive aid, Japan is likely to play a major role in organizing multilateral aid consortia over the decade.

35. Beyond these activities, most Japanese probably do not have any very clear concepts about Japan's role in the world. The majority of voters are much more interested in seeing urban traffic unclogged or farms modernized. Even many of the businessmen most active in foreign countries are eager to avoid the sort of political involvement which might offend, and thus damage trade with, anybody. But finding a suitable "world role" has become an important goal for some leaders of the Japanese Establishment, and is an area of potential disagreement and friction among them.

²In 1969, Japan probably reached second place among developed countries in terms of total financial outflows to underdeveloped countries with a total approaching \$1.3 billion. However, only \$436 million of this was official aid, while private aid flows (export financing and overseas investment) was estimated at \$800 million.

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The Pacific Power Balance

36. Japan's search for its place in the world will evolve against a background of the balance among the 4 great Pacific powers—the US, USSR, China, and Japan itself. The present equilibrium is highly favorable to Japan. The antagonism and military standoff among the 3 other powers gives Japan great freedom to pursue its own interests without immediate worries about its security. Moreover Japan, as the least ideologically committed of the 4, can expect each of the other 3 in some way to bid for its favors as the decade goes on. The reverse of this picture could of course also be true: a major shift in the behavior of one or more of the others, and especially a collapse of the balance among them, could leave Japan the most exposed and vulnerable of the world's major powers. In the immediately following paragraphs, we assume the following continuity in Japan's Asian environment: that the Sino-Soviet split will endure, and that the US, while less visible militarily, will remain a factor in Asia. (Section V discusses the implications of certain contingencies which might alter this framework.)

37. *The US.* Japan's closest ties—economic, political, and military—are of course with the US and likely to remain so. Economic links, more than anything else, cement this relationship. The Japanese economy is heavily dependent on the US, to which it now sends about 31 percent of its exports. Moreover, during the 1960s the composition of these exports shifted from light manufactures to the more sophisticated industrial products on which Japan's further economic growth depends. There is no apparent alternative market for these Japanese exports, especially so long as the European Community maintains import restrictions on Japanese goods. In addition, Japan depends on the US for some 27 percent of its total imports, including a growing supply of raw materials, and advanced production and scientific equipment not readily available elsewhere. These economic links are of course supplemented by Japan's reliance on the US for military protection, and by the advantages of having American approval and international sponsorship.

38. This very history of quasi-dependence on US goodwill and diplomatic effort, however, is a potential source of weakness in the US-Japanese relationship. For an increasing number of Japanese, an essential component of their nation's "great power" status will be its ability to stake out and defend political and economic positions independent of the US and at times in conflict with it. For these Japanese, the issues may go beyond specific measurements of gain and loss to encompass delicate questions of "face" in the international community. This does not mean that a major breakdown of US-Japanese relations is likely to occur on such issues as Japanese textile exports to the US. But it does forecast a diminished willingness in Japan to bow to US pressures on JGJ and other important controversies. Economic conflicts are virtually inevitable over the decade, as US businessmen try to open Japan to foreign goods and capital, and at the same time to restrict Japanese imports into the US. Competition for third country markets could also become acrimonious, and differences could arise over trade and credit policies toward China. Such issues are likely to be

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a much greater source of friction between the two governments than the much publicized matter of US military bases in Japan. Nevertheless, we expect that for Japan the areas of mutual benefit in its relationships with the US will continue greatly to outweigh the areas of conflict.

39. *China.* China looms large in any calculation about Japan's role in Asia. It is potentially both the most tempting Asian market for Japanese goods and Japan's greatest rival for influence in East Asia. In time, Japan might also come to see China as a military threat, although there is little concern on this score at present. The Japanese hope that if they keep from provoking Peking and expand economic and eventually political links they will somehow help to draw China into a more moderate course in its international relationships, meanwhile increasing Japan's role in its economy and leverage on its politics. They probably also see China's present hostility to the US and USSR as a special opportunity to improve Japanese influence in Peking. There is very little Japan can do to advance its aims so long as the Chinese leadership remains so hostile to its "bridge-building" efforts. But it will persevere.

40. Japan's efforts to improve relations with China probably will include—fairly early in the decade—willingness to extend long-term credits for Chinese purchases of Japanese capital goods, and somewhat later, offers of diplomatic recognition based on a formula that provides tacit acceptance by Peking of continued Japanese relations with Taiwan. How fast to move in this direction will be one of the livelier issues of Japanese politics. Japan is not likely to be seriously deterred from overtures to China because of the anguish these might cause in Taiwan or the US. But the chief importance of China in Japanese thinking may be negative, by making Japan wary of doing anything in the rest of Asia which might provoke China today, lest it diminish Japan's chances for improved relations in the future.

41. *The Soviet Union.* We do not foresee the development of anything resembling a close political relationship between Japan and the Soviet Union in the 1970s. The Japanese have long distrusted Russian ambitions in Asia, and now would be especially cautious about closer ties with the USSR which might antagonize China. The Soviets, for their part, clearly have mixed feelings about their relations with Japan. They routinely denounce Japan as a staging base for "capitalist" influence, and of course for the US military, in Asia. But they may be coming to wonder whether Japan's influence in Asia, and even its military tie with the US, might be a useful counterforce to China. Japanese-Soviet relations are likely to continue erratic during the decade, with the Japanese suspicious but always eager to respond to Moscow's friendlier moods. As a general rule, the more antagonistic the Sino-Soviet relationship, the more incentive the Soviets have to encourage reasonably friendly relations with Japan. But prospects are not good for a formal change in relations, e.g., a peace treaty to conclude World War II, unless Moscow should find compelling reason to return the southern Kuril Islands and neighboring islets taken from Japan at the end of the war. This now appears unlikely.

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42. In the economic sphere, there are things the Soviets and Japanese want from each other. Chiefly, Moscow wants Japanese money and technical expertise for the economic development of eastern Siberia and the Soviet Far East, and the Japanese are interested in that region's industrial raw materials. There will be progress along these lines, but it will be slowed by the Soviet tendency to demand more capital and easier terms than the Japanese wish to offer. Moreover, this development is not of first importance to either country. Japan can for the most part find more attractive sources of raw material supply, and the Soviets give relatively low priority to the development of their eastern lands.

The "Developed" World

43. Thus Japan has an "umbrella" of the Pacific power balance, as well as of its military alliance with the US, under which to pursue its international ambitions. One immediate question about those ambitions is what part of the world Japan belongs in. Its leaders often like to identify with the industrialized powers of the West—reflecting both justifiable pride in Japan's economic achievements and corresponding arrogance toward their nearer neighbors. This emotional attraction accords with Japan's economic interests, which are focused especially on the sophisticated markets and vast raw material sources of the US, Canada, Australia, and New Zealand. In political and strategic terms, Japanese leaders like to think of an informal community of these developed *Pacific Basin* nations—a grouping of rich and politically stable states connected by safe lines of air and sea communication. The Japanese and Australians, for instance, share major areas of mutual interest: Australia's continued economic growth is largely tied to Japanese purchase of its raw materials; and despite quite different policies, the two share basic goals with respect to Asian security problems. Much of Japan's diplomatic activity over the decade will be devoted to strengthening ties with the Pacific Basin states, perhaps extending to some sort of formalized political grouping among them.

44. The Japanese also look to the nations of *Western Europe*, measuring with pride Japan's greater economic gains and with some sensitivity its lower standard of living. They hope to increase sales of Japanese products in Europe's affluent societies, which in addition to the economic advantages would help decrease Japan's reliance on American markets. Recently the EEC countries have also shown increasing interest in broadening trade with Japan.³ Wider economic relations in turn would facilitate closer political relations between Japan and Western Europe. Japan might in some circumstances seek help from France for its nuclear program, e.g., in acquiring unsafeguarded uranium or even in developing a missile guidance system. And the Japanese probably also feel a common interest with the West Germans on nuclear matters, especially in opposing the restrictions placed on both by the Nuclear Non-Proliferation Treaty.

³ During the past decade, West Europe accounted for only about a constant 10 percent of Japan's total trade while Japan had less than 2 percent of West Europe's trade, although this latter figure doubled over the decade.

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East Asia

45. While the developed world may be more attractive to Japan, Japan clearly comes first in the economic calculations of its non-Communist Asian neighbors. It has overtaken the US as the chief trading partner of almost every country in East Asia, and is the prime market for the raw materials which are virtually all that many of these countries have to sell. South Korea and Taiwan have in some respects become extensions of the Japanese economy, as Japanese firms have moved into both in order to take advantage of lower labor costs. Elsewhere in East Asia, Malaysia, Singapore, Hong Kong, or Thailand might also be attractive sites for Japanese investment in labor intensive industries along the pattern of South Korea and Taiwan. Otherwise, Japan is chiefly interested in those states with abundant raw materials and reasonably stable political life. Thus Indonesia, Malaysia, and Thailand, in particular, are targets for Japanese investment in extractive industries. Indochina, on the other hand, will be of relatively little economic interest until postwar reconstruction begins.

46. However aloof Japan might like to remain from the political troubles of its Asian neighbors, its economic role does in fact carry with it an implicit entanglement. Most Japanese, especially among the younger generation, appear indifferent to anti-Communist appeals, but they do want Asia to be sufficiently stable for Japanese to go on doing profitable business there. The issue in Japanese minds is what role Japan ought to play in bolstering Asian security. Their instinctive response is in economic terms. The region will continue to get the bulk of Japan's foreign aid. This still will be primarily aimed at advancing Japanese commercial enterprise; but as the decade goes on Tokyo may be more willing to use aid money for promoting overall political stability and general economic growth. Japan already has taken the major role in the Asian Development Bank, and sponsored regional meetings on such subjects as agricultural development and Indonesia's debt. The Japanese may view themselves as a kind of middleman between the developed states and their more backward Asian brothers. Particularly in the UN, they may try to be East Asia's spokesman to the West.

47. *The Special Cases of South Korea and Taiwan.* South Korea and Taiwan are special cases for Japan, by virtue of their strategic location in Northeast Asia, Japan's heavy investment in their economies, and historical ties with both. In both cases, government exchanges will grow in matters of intelligence and internal security. The Japanese count on continued US guarantees to both countries, however, and hope not to have to do much more about the security of either neighbor. The Japanese public does not share its leaders' sense of involvement in the fate of either country, and any projected "military adventure" abroad would be a divisive issue even within the leadership. We do not believe it would involve itself in the defense of Taiwan in any foreseeable circumstances if only from fear of conflict with Peking.

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48. South Korea is a less clearcut case. But so long as the US commitment there seems dependable Japan is unlikely to play more than a marginal military

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role in its defense, as a base for US operations, and if necessary as a guardian of the sea lanes between Japan and the peninsula. The Japanese are generally optimistic about prospects for avoiding conflict in Korea. And they see a unique role for themselves: to improve their own relations with North Korea and so help "civilize" it; and to work for a North-South modus vivendi, thus defusing the threat of war before the US loses interest in South Korea's fate. If, however, there should be a renewed threat to South Korea from the North which Washington seemed unlikely to meet resolutely, Japanese politics would be strained by the question of Japan's role in the struggle and especially of whether to send troops to defend the South. Some government leaders probably would want to intervene, but it is doubtful that they could create a national consensus in favor of action. Many Japanese, especially the younger ones, see little compelling national interest in the preservation of a non-Communist South Korea and feel no threat to Japan from North Korea.

49. *Southeast Asia.* The Japanese also are testing the waters for what political role they might play in Southeast Asia. They will increasingly want to be included in Asian talking groups, e.g., a conference on Cambodia or expanded Vietnamese peace talks. They probably would join, and gradually play an important role in, any UN or other international peace-keeping activity in Southeast Asia arising out of the Indochina war. Japan will try, however, to keep all its Southeast Asian activities multilateral and non-military. It wants to avoid alarming its neighbors about its own ambitions in the area, but even more it wants to avoid direct responsibility for any other country's troubles or in any two countries' quarrel. Clearly, one motive for Japan's growing emphasis on regional forums is its desire to avoid bilateral responsibility and to keep pressure on the US, Australia, and New Zealand for continued involvement in Southeast Asia's problems.

The Role of the Military

50. The greatest uncertainty in Japan's groping for a "world role" is how the military might contribute to it. The Japanese Establishment is agreed that some modest increase in military forces is desirable, if only for reasons of self-respect and national prestige. This argument is reinforced by a desire to become more obviously independent of the US, and perhaps by the hope of some that a larger Japanese military would enhance Tokyo's position with respect to the US, USSR, and China. There are powerful domestic interests which have a personal stake in going further still. Some important Japanese industrialists, with an eye on possible government contracts, are far ahead of the politicians in pressing for stronger military forces. And some ambitious Liberal Democrats, most notably Defense Director Nakasone, may try to play upon the growing desire for prestige and profits by very ambiguous statements about Japan's military future. If the 1970s should see a contest between the LDP and Komeito as to which is more "patriotic", this too could fuel the desire for a large military establishment.

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51. There is a potent school of thought, probably comprising a majority at present, who think quite differently. These men question the traditional coupling of "great power status" with strong military forces, especially in Japan's position as a recognized giant among its weaker neighbors. They argue that Japan's economic relations and political influence in East Asia would be damaged if it acquired the military trappings of great power status. They also question just whom Japan should arm against. Few Japanese currently perceive a military threat to their own lands. And there is widespread aversion to being drawn into Washington's conflicts with Asian communism. Any potential threat to Japan in the future would certainly come from a nuclear power, against whom "conventional self-sufficiency" would be of little use unless backed by nuclear weapons. And the sort of token nuclear force which some Japanese might desire as a status symbol would be bitterly divisive at home and damage the image Japan is so assiduously promoting abroad, without really achieving strategic independence from Washington. If this line of reasoning prevails, the Japanese just might be the first major nation to ask: "military power—for what?". These and other arguments against a massive military buildup will find considerable sympathy among the Japanese public, which is by no means cured of its "nuclear allergy", which is still apprehensive about militarism, and which moreover is reluctant either to pay for or enlist in a large defense establishment.

52. Given anything like the present international circumstances, Japan's course among these conflicting pulls almost certainly will be a compromise which avoids foreclosure of any option for future decision. Ambitious politicians will look for ways to exploit the issue, but none will want to expose himself to attack by getting too far ahead of the consensus. And consensus will be slower in coming as the decisions become more difficult.

53. *The Military Buildup.* The Fourth Defense Plan, now being drafted to cover the years 1972-1976, will be based on the assumption that the US-Japanese Security Treaty will remain in effect. The Treaty may be "reinterpreted" to meet changing circumstances, but the government will want to avoid a more formal change which would require Diet or Congressional approval. The Defense Plan is expected to provide for a slow and orderly augmentation of the Self-Defense Forces, with emphasis being placed on qualitative improvement through equipment modernization and new procurement. First priority is to be given to improving the navy and air force; there also is to be some improvement in the ground forces mobility and capability for joint operations. By 1980, the defense budget could go to as much as 2 percent of the GNP⁴—still relatively small proportionally but enough to give Japan the world's 4th or 5th largest defense budget. Recruiting, however, will continue to be a problem, partly because of Japan's growing labor shortage. It is highly unlikely that Japan's Constitution will be amended or reinterpreted to allow conscription.

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DATE: NOV 2008

⁴ It is now .79 percent compared to US 9.5 percent, and about 5 percent in the UK, West Germany, and France.

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54. The defense related industries are likely to grow proportionately more than defense forces in the coming years. A major effort will be made to produce most military equipment at home. High on the military-industrial shopping list are research and development contracts, as well as production orders, for such advanced items as antisubmarine detection and landbased radar systems, a variety of electronic equipment, a wide range of ships and aircraft, and rockets and antimissile missiles. There also will be pressure on the government to allow Japanese industry to produce such things as bombers, "non-nuclear" ballistic missiles, and antiballistic missiles, and to ease restrictions on foreign sales of military equipment. All this would put Japan in a position to reduce its own purchase of US military goods and might eventually add an important line of exports, thus bringing Japan into competition with the US for sales to third countries.

55. We do not, however, expect a dramatic change in the role of the forces Japan will be building during the 1970s. The navy and air force will extend their area of operations, partly as a result of responsibilities assumed with the reversion of Okinawa, and eventually will come to accept a greater share of responsibility for defense of Japan's vital lines of communications. The decade will probably also see routine Japanese naval cruises in the Straits of Malacca and perhaps in the Indian and South Pacific Oceans. But it is unlikely that Japan will want to station any forces abroad or to accept foreign military commitments—certainly not bilateral ones. At most, Japan might contribute some civilian police and security officers to an international truce-keeping force for Vietnam or possibly some UN operation further afield.

56. We are less certain about Japan's military nuclear future. Some in the Establishment see a national nuclear capability as a natural component of Japan's "big power" status. A far greater number of Japanese still are appalled by the very idea. And most probably are sincerely troubled at the prospect of having to choose between continued and obvious reliance on the US, and the economic and political costs to Japan of acquiring its own nuclear weapons. The policies of other nations will be important. Japan's nuclear temptations will be stronger if several others, especially another Asian, should acquire a capability. And Japan's eventual decision will be profoundly affected by US and Chinese postures, or what the Japanese think them to be. An antiballistic missile system would be especially relevant for Japan if it felt exposed to a hostile China and uncertain about the US. If Japan wanted to acquire a nuclear antiballistic missile it would have to denounce the Nuclear Non-Proliferation Treaty (which it has signed but not yet ratified); but this probably would not of itself be a major obstacle.

57. On balance, we think that unless the Japanese come to feel some fairly imminent threat to themselves for which US protection is deemed insufficient, the restraints will outweigh the temptations at least for some years. **APPROVED FOR RELEASE DATE NOV 2009** Outside from entering a foreign war, acquiring nuclear weapons would be the most controversial step any Japanese government could take and the one which would make it most vulnerable to political criticism, especially from within leadership circles and from its Asian neighbors.

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58. Japan certainly will want to keep its nuclear option open, through development both of peaceful uses of nuclear energy and of a sophisticated space program. Japan is in a position, if it chose to ignore safeguards on fissionable materials presently on hand, to produce a nuclear device some two to four years after deciding to do so. Another year or two would be required before operational nuclear weapons would be available. One probable motive for Japan's commercial space program is to develop the capability for a medium- or long-range missile. A strategic missile development program based on existing technology and launch vehicles would take a minimum of three to five years to complete. As technology and hardware which the US has agreed to supply is exploited, the development time probably will be reduced by a year or so.

59. *US Bases.* Japan's efforts to build up its conventional military forces will reinforce already growing desires for reduction of the US bases in Japan and Okinawa. Defense Agency Director Nakasone has made public suggestions for joint US-Japanese use of US bases and for the eventual return of all US facilities to Japan's Self-Defense Force or to the public for non-military use; the Japanese especially want to reclaim land now used by US forces around crowded urban areas. While it is possible that there could be a snowballing of opinion against the US bases at some point in the decade, it seems more likely that the Japanese will press for gradual transitional arrangements with joint use leading eventually to complete Japanese assumption of control. During the 1970s, Tokyo may want to reduce the US base structure to little more than the naval bases at Sasebo and Yokosuka, the Misawa airbase in northern Honshu, and a few major air and logistics installations on Okinawa, all of which can be considered important for the protection of Japan and its security interests in Northeast Asia; even in these instances, the Japanese probably will press for the formal transfer of the bases to their control. Although tacitly accepting considerable US freedom of action in use of such bases, the Japanese will clearly interpret their right of "prior consultation" over the deployment of US forces from Japan as a veto power. But so long as Japan is ultimately dependent on US military protection, it probably will want to keep some US bases in order to facilitate and give credibility to that protection. And, in the interests of regional security, it will not want to dilute too obviously the US deterrent to Chinese or North Korean aggression on the mainland.

IV. UNSETTLING CONTINGENCIES

60. The government's ability to follow the cautious, option-holding course we have outlined depends not only on its own efforts but also on the international environment in which it will be operating, and especially on the behavior of the three major powers—the Soviet Union, China, and the US—against whom Japan measures its interests. If, to take the most extreme case, the US and China should patch up their differences and seem genuinely threatening toward Japan, and if at the same time the US should be going through a spell of post-Vietnam isolationism, the Japanese probably would feel forced to change course. The government would have to either mount a politically difficult and costly

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independent military effort, including the production of nuclear weapons, or try to reach accommodation with the threatening power(s). Whether it could establish some kind of consensus in favor of either course, or would have to face a bitterly divisive polarization of the nation, is difficult to predict and would of course depend on the circumstances in which the threat arose.

81. Much of course depends on the future of Sino-Soviet relations, and whether Japan can continue to expect each of the rival Communist giants to be at least friendly enough to want to keep Tokyo from the arms of the other. The *Soviet Union* has the greatest capacity to threaten Japan, and is the power which has historically most worried the Japanese. But most Japanese expect the USSR to remain essentially a conservative force during the 1970s, guarding the status quo at home and in what is left of its satellites. *China* is a much more doubtful factor in Japan's long-run calculations. All Japan's Asian policies, as well as its defense thinking, largely hinge on whether the Japanese continue to see China more as a source of potential opportunity than as a threat.

82. The central factor in Japanese strategic calculations, however, will continue to be the US. So long as the Japanese believe they can depend on Washington's protection, they are unlikely to be panicked into abrupt departures in their own defense policy. As we have noted above, large US forces in Japan will not be necessary to make the alliance seem valid, but neither will US forces in Japan alone be entirely sufficient; some important Japanese would be seriously alarmed by the spectacle of an "abandoned" and threatened South Korea. By contrast, further escalation of the fighting in Indochina could revive Japanese fears that their military ties with Washington might somehow draw them into conflict with China.

V. IN SUM . . .

83. Japan, then, is embarked on a self-conscious search for its "rightful place" in the world. But barring some fairly dramatic change in the international environment its progress will be cautious, as the government carefully feels out what the traffic will bear at home and abroad. It will have to maneuver among the competing claims of domestic needs and international ambitions, to balance aspirations for political status and influence against fears of being drawn into other people's problems or hurting trade.

84. As Japan goes on getting richer, its citizens will become even more self-confident in pursuing their economic interests abroad. By the end of the decade, Japan will be more nearly an equal in its economic relations with the US; is likely to be the dominant external factor in the economic life of non-Communist Asia, and the largest external economic influence in China, Australia, and New Zealand; and in all likelihood, will be the greatest single economic power in the world. The US even in such traditional American preserves as Latin America will be somewhat more careful about political than economic assertiveness. While increasingly eager to assume a major role in multilateral forums, it will continue wary of bilateral commitments, particularly any requiring a military contribution.

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65. There will inevitably be disagreements with the US on many issues. Japan will be too assertive economically to suit American businessmen, and less willing to take a security role than Washington might wish. It will continue to expect US nuclear protection as a matter of America's own interest, without being willing to do much in return. And it will be increasingly sensitive to Japanese interests in international negotiations over, for instance, nuclear power. Nevertheless, the essential ties with the US will endure, based on economic interdependence and mutual interest in the stability of East Asia—a community from which Japan cannot withdraw. But Japanese awareness of their reliance on these ties will itself add to their desire to *appear* independent of the US, especially in Asian policies. Probably more important than any specific change in Japan's world role will be the change in Japanese attitudes. Especially in military matters and in relations with the US, pragmatism will prevail over sentiment in Japanese thinking. One of Japan's chief goals in the 1970s, a motive force behind the search for diversified resources and markets, the development of Japanese technology, the buildup of military potential, and the groping for a political voice, will be to increase Japan's ability to act independently of—or in certain circumstances in conflict with—the US.

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Emergence of the Japanese Red Army

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Emergence of the Japanese Red Army

Summary

For the past two and one half years a relatively small group of Japanese terrorists, working with the Popular Front for the Liberation of Palestine (PFLP), has conducted or collaborated with the PFLP in three terrorist operations. These incidents--the Lod Airport massacre in May 1972, the Japan Airlines (JAL) hijacking in July 1973, and the Singapore incident in January 1974--are believed to have been planned by the PFLP and then implemented with the assistance of Japanese radicals operating out of the Middle East. In the recent successful operation in the Hague to secure the release of Furuya Yutaka, a Japanese Red Army (JRA) comrade held in a French jail, the JRA appears to have acted independently of the PFLP. An interrogation of Furuya led French police to a network of JRA members in Paris which was planning attacks on Japanese businessmen and a diplomat in Germany. In spite of obvious flaws in the forged documentation carried by JRA members in past operations, JRA terrorists were still able to enter target countries with little, if any, difficulty.

Origin of the Japanese Red Army

Current information from [REDACTED] the U.S. Embassy in Tokyo indicates that the JRA has little support from or connection with other terrorist organizations operating in Japan. The JRA is not "red" in the old communist interpretation of the word and is not an army in the conventional sense. The JRA has no known ties of any kind with the USSR, China, or the Japanese Communist Party and appears to have little or no appeal to most leftist Japanese youth. Little is known concerning its ideology other than adherence to a form of world revolution in which the masses will rise up and defeat the existing imperialist governments.

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In 1969 a group calling itself the Red Army emerged in Japan, advocating violent revolution. This organization apparently was little different from the approximately 27 other radical groups then operating on Japanese campuses. [REDACTED]

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[REDACTED] In the past five years several groups which could have had their antecedents in the old Red Army of

1969 have emerged with such names as the Red Army Faction, The United Red Army, The Red Army Guard, The World Red Army, The Red Army Arab Committee and now the Japanese Red Army.

[REDACTED]

1.5(c)
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Available information indicates that Shigenobu Fusako, currently thought to be the leader of the JRA, made contact with the PFLP in 1971. In May 1971 she helped produce a film called "The PFLP and the Red Army Declare World War." She also appears to have participated in the publication of a book entitled The Arab Guerrillas and the World Red Army. It is not known whether Shigenobu and her JRA followers initiated contact with the PFLP on their own volition or as the agents of a terrorist organization inside Japan.

[REDACTED]

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Okudaira and two other Japanese radicals were trained and sent by the PFLP into Israel to perpetrate what is now called the Lod Airport massacre in May 1972. It is likely that the three men were not members of any well-established organization in Japan, but rather individuals who were motivated by the goals of the PFLP in combating Israel.

[REDACTED]

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A PFLP spokesman in June 1972 readily admitted that the PFLP had trained and dispatched the Japanese terrorists on the Lod mission.

Following the Lod operation there were a few reports that Japanese radicals and the PFLP intended to mount more joint operations. [REDACTED] the targets were to be airport facilities in Germany, Switzerland, Italy and France. The Japanese reportedly made this agreement with followers of Wadi Haddad, chief of the PFLP's Foreign Operations Committee, but without the knowledge of PFLP leader George Habbash.

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On 20 July 1973 a combined JRA-PFLP group hijacked a Japan Airlines (JAL) Boeing 747 as it departed Amsterdam's international airport. The aircraft finally landed four days later in

Libya, where the terrorists destroyed the jet with explosive charges.

[REDACTED]

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During the JAL operation the four terrorists described themselves as members of the Sons of the Occupied Land Organization (SOLO) working with the JRA.

[REDACTED]

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SOLO also claimed credit for the bombing of a JAL office in Bonn, Germany on 31 May 1974.) The JAL hijacking was the first instance in which the title JRA was linked publicly with the PFLP.

Several months later the PFLP and the JRA struck again, this time against the Shell oil refinery on Pulau Bukum Island near Singapore. Two PFLP terrorists and two JRA members set fire to one oil storage tank and attempted to blow up three others before seeking to escape from the refinery in a ferry boat. Shortly after they seized the ferry, the four men identified themselves as members of the Japanese Red Army and the PFLP.

In a press conference the day after the attack, a PFLP spokesman in Damascus described the operation as a warning to monopolistic, exploitative oil companies and as a rejection of the Geneva efforts for a peaceful settlement of the Palestine problem. Negotiations between Singapore authorities and the terrorists dragged out for seven days, and on 6 February five PFLP terrorists seized the Japanese Embassy in Kuwait and demanded that the four Singapore terrorists be released and flown by the Japanese government to Kuwait. After the Japanese and Kuwaiti governments agreed to these conditions, the four Singapore terrorists and their five comrades were flown from Kuwait to Aden, where they were subsequently set free.

[REDACTED]

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Japanese Red Army Activities in Europe

On 26 July 1974 French authorities arrested Furuya Yutaka, a Japanese national, for possessing four altered passports and ten thousand dollars in counterfeit U.S. Federal Reserve notes.

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[REDACTED] members of the Curiel Apparatus were providing support to the JRA. The Curiel Apparatus is a Paris-based "leftist" organization which has provided support in the way of training, documentation and financial assistance to revolutionary and national liberation groups in numerous countries. Financial support for the Curiel group is believed to come from fees it receives for services rendered to the various organizations it assists.

The most important JRA member arrested and interrogated was Takahashi Taketomo, believed to be the chief of the European network of the JRA.

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JRA Secures Release of Furuya

Three JRA members successfully obtained the release of Furuya (Yamada) from a French prison in mid-September, in a well-planned and coordinated operation which involved seizing the French embassy in the Hague and trading the Ambassador and eight other hostages for Furuya and his documents.

The hostages were held from 13 to 17 September, when Dutch and French authorities finally reached an agreement with the JRA terrorists. After leaving behind their hostages, the terrorists were given U.S. \$300,000 and were allowed to leave Amsterdam in an Air France 707 flown by a volunteer crew.

[REDACTED]

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[REDACTED]

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JRA Modus Operandi

While there is little information available on the JRA to illustrate definite patterns of operation which could be indicators of impending attacks, a few generalizations can be made on the basis of their past attacks.

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[REDACTED]

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Unfortunately no pattern of JRA activities can be obtained by comparing the Lod and Singapore incidents, because the operations were so different. At Lod the task was to kill as many people as possible with automatic weapons and grenades. Therefore a minimum amount of preparation was necessary. At Singapore, however, the terrorists prepared detailed plans over a month in advance.

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MEMORANDUM FOR: Members of the Working Group
Cabinet Committee to Combat Terrorism

SUBJECT : Study on the Japanese Red Army

1. Attached for your information is a copy of a study entitled "The Emergence of the Japanese Red Army". The study traces the origins of the Japanese Red Army (JRA) with emphasis on its past terrorist operations in conjunction with the Popular Front for the Liberation of Palestine (PFLP). The discovery of a large JRA network in Paris is also discussed in detail.

2. Copies of a revised edition of this study are being disseminated abroad to selected liaison services.

3. Additional copies may be obtained by contacting this office [REDACTED]

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CIA Member, Working Group
Cabinet Committee to Combat Terrorism

Attachment:
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MEMORANDUM FOR: D/OER; D/U; SC/P/C(2)
1-CRS/256 (4/2/75)

The attached material was forwarded to Mr. J. Mishell George, Director of Joint Commission Secretariat, Department of Commerce. They will form part of a briefing book being assembled in support of the Fifth Session of the Joint US-USSR Commercial Commission, which is to meet in Moscow on April 10-11, 1975.

H

27 March 1975
(DATE)

BACKGROUND PAPER

Japanese-Soviet Negotiations on Siberian Economic Development

The pace of Japanese involvement in Siberian and Far Eastern development picked up markedly with the recent signing of three separate agreements dealing with (a) forestry development, (b) exploitation of coking coal deposits, and (c) exploration and development of offshore oil and natural gas. Negotiations are also under way for pulp/paper plants costing more than \$1 billion. Prior to 1974, the Japanese had signed agreements for a small forestry development project (1968), port construction at Vrangal Bay (1970), and a wood chip processing plant (1971).

Projects Completed and Underway

Timber and Forestry Agreements

In 1968 the USSR and Japan concluded a five-year agreement on the development of timber resources in the Sikhote Alin Mountain area of the Soviet Far East. Under the agreement, a Japanese consortium supplied \$166 million worth of equipment and consumer goods. A second and larger agreement was signed last July whereby the USSR will receive \$550 million in timber cutting and processing equipment, ships, and consumer goods. In both cases, Soviet purchases are covered by Japanese Eximbank credits. Soviet ability to repay the credits was guaranteed by long-term Japanese commitments to purchase Soviet timber. In 1971 a different Japanese consortium concluded an agreement for the construction of a wood chip plant. The USSR received \$50 million in equipment and consumer goods under credit in return for deliveries of wood chips and pulp over a ten-year period.

Port Development

In December 1970 an agreement was signed for construction of a new seaport, Vostochny Port, located on Vrangal Bay about nine miles from

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Nakhodka. The Japanese Export-Import Bank furnished an \$80 million credit for machinery and equipment. The new seaport will be capable of loading coal and wood chips as well as handling containerized cargo. Storage and warehouse facilities, railyards, and a railroad spur connecting with the Trans-Siberian railroad are being built. Vostochny Port could play an important part in long-term Soviet-Japanese development of Siberia since it would facilitate movement of goods and raw materials of considerable interest to Tokyo.

Chul'man Coal Deposits

In June 1974 the USSR signed an agreement with a consortium of Japanese firms to develop coking coal deposits near Chul'man in Eastern Siberia. Concomitantly the Soviets concluded an agreement with Japan's Eximbank for \$450 million in long-term credits to finance Soviet purchases of coal mining equipment, railway equipment, and consumer goods. In return the USSR will supply the Japanese consortium with 104 million tons of coal in 1979-99, representing 5% of projected Japanese needs. Soviet earnings from the project could exceed foreign exchange costs by several billion dollars. US firms may be asked to supply some of the advanced equipment required by the USSR.

Offshore Exploration for Sakhalin Oil and Natural Gas

In January 1975 the USSR and Japan reached agreement to jointly explore oil and natural gas deposits along a portion of the continental shelf around Sakhalin Island. A Japanese-led consortium will extend up to \$200 million in risk capital over the next five years to cover its share of exploration costs, and the USSR will receive \$50 million in capital goods under an Eximbank credit. In return Moscow has granted the consortium a long-term option to purchase up to one-half of all oil recovered.

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Projects Under Discussion

Pulp/Paper Plants

Moscow has requested Japanese firms to submit cost estimates for two pulp/paper plants to be built in the Soviet Far East. Together the plants would have a planned annual production capacity of roughly 1 million tons of newsprint, paper, and bleached pulp and are expected to cost over \$1 billion. The Japanese would probably import a sizeable share of the output.

Yakutsk Natural Gas Exploration

1. April 1974 the Japanese Eximbank agreed to provide \$100 million in long-term credits to finance the Japanese share of the exploration phase of the Yakutsk natural gas project. The loan was contingent on the availability of matching funds from the US, which have not yet been granted. (Additional information on Yakutsk is contained in a separate paper.)

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~~BACKGROUND PAPER~~

Major Credit Needs and Availability for USSR

Need for Credits in Perspective

Moscow has relied heavily on medium and long-term Western credits to finance capital equipment imports from the West since these credits became generally available in the mid-1960s. Credits covered practically the entire hard currency trade deficit incurred by the USSR in 1966-71. Very little gold was sold. In 1972-73, the USSR incurred a cumulative deficit of \$3.1 billion, more than double the deficit of the previous six years. In large part the deficit resulted from record imports of Western grain. Even so, the USSR imported a substantial volume of machinery and equipment thanks to the availability of Western credits. Net Western medium-term and long-term credits of \$1.3 billion covered less than half of the deficit of 1972-73. Large sales of gold (at rising prices) and short-term borrowing covered the remainder.

Large Soviet Orders Based on Credit

Heavy reliance on Western credits enabled the Soviets to boost orders for machinery and equipment to \$4.1 billion in 1974 compared with \$2.3 billion in 1973. Also in 1974, the USSR contracted for about \$2.5 billion in large-diameter pipe in Western Europe. The majority of the equipment orders and all of the pipe orders are supported by long-term Western credits which will be drawn down as deliveries are made in the next few years.

Continuing Need for Credit

The turnaround in terms of trade with the West and the resulting hard currency surplus of \$1 billion in 1974 does not signal the end to Soviet need for Western credits. For one thing, continuing inflation in the West is eroding the price advantage recently won by Moscow. Secondly, Moscow's

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strategy for increasing trade with the West relies on a continuing stream of long-term credits, especially in connection with its ambitious resource development projects and their commodity pay-back provisions. Thirdly, even if the USSR continued to generate hard currency trade surpluses, Moscow still would profit from using low-interest, long-term credits if the rate of inflation continues to exceed the interest rate.

Ready Availability of Credit

Nearly all major Western countries continue to offer large lines of credit with easy repayment provisions to promote their exports to the USSR. Recent lines of credit include (a) the April 1974 extension by Japan of \$1.1 billion in support of Siberian development projects, (b) the December 1974 extension by France of \$2.6 billion, (c) the January 1975 extension of Italy of \$600 million, and (d) the February 1975 extension by the United Kingdom of \$2.3 billion. In addition, Japan continues to grant low-interest, long-term credits to support other equipment orders. An additional \$1-\$2 billion in credits from Japan and Italy seem likely in the near future. The West German government does not subsidize interest rates as do other Western governments; instead, the German financial community continues to come up with substantial long-term credits to support major equipment orders placed by Moscow, notwithstanding the alleged cash deal for the Kursk steel project. Meanwhile, Moscow is able to augment these traditional sources of credit by borrowing in the Eurocurrency market and from the newly affluent oil-producing nations.

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Current Outlook for the Soviet Economy

The Soviet economy grew by an estimated 3.2% in 1974, shielded from the recession and double-digit inflation plaguing the West by (a) its centrally controlled economic mechanism, and (b) its high degree of economic self-sufficiency.

- Industrial output in 1974 grew an estimated 6.8%, the highest rate since 1970. The leading growth sectors were energy, producer durables, chemicals, and processed foods, a reflection of the priority given technological advance and expansion of farm output.
- Agricultural production fell 3.3% below the record set in 1973 because of poor weather; nevertheless, grain output at 195.6 million tons was the second largest in history, and cotton output reached a new high. Moscow bought only 6½ million tons of Western grain for delivery in fiscal year 1975, compared with 10½ million tons delivered in FY 1974, and carried over large grain stocks from the 1973 record harvest.
- Consumer welfare continued its steady rise, featured by increased availability of meat and dairy products, soft goods, and automobiles.
- The hard currency trade surplus reached an estimated \$1 billion in 1974, compared with a nearly \$1 billion average deficit in 1970-73; price increases for Soviet oil and other raw materials far outweighed price increases for imports. Trade with the West boomed, growing by almost 48% and accounting for 31% of total Soviet foreign trade.

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The Soviet economic plan for 1975 anticipates that GNP will grow at more than double the 1974 rate.

- The planned matching of last year's industrial growth will be difficult to fulfill. According to Soviet statistics, industrial output this January grew only 6.7% compared with 9.6% in January of last year.
- A jump of almost 11% in agricultural output is scheduled. So far this year the weather has been favorable for winter grains, making a record crop possible. Moreover, history shows that good winter crops are usually followed by bumper spring crops.
- Many original consumer targets for 1975 will not be met because of disappointing harvests and lackluster performance in housing and the light and food industries. Nonetheless, Moscow remains firm in its commitment to raise living standards, as witness the continued strong support for agriculture in 1975.
- The hard currency trade surplus in 1975 may match the \$1 billion of 1974 in spite of a decline of some raw material prices. This financial cushion will help the Soviets to pay cash for some purchases and to resist high interest rates for Western credits.

From a longer-run perspective, the Soviet economy continues to be restrained by endemic problems. Moscow cannot readily translate its temporary advantages in dealing with the West into remedies for these problems.

- Increases in productivity remain below expectations, particularly in the farm sector.

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- The slow introduction of new techniques and new products into large-scale production continues to characterize Soviet industry and is unlikely to be remedied by the piecemeal reforms under consideration.
- The poor assortment and quality of consumer goods, the dismal quality of consumer services, and the housing shortages persist.

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Japan's Changing Relations With China and the USSR

A Research Paper

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PA 81-10040
February 1981

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Japan's Changing Relations With China and the USSR

A Research Paper

*Research for this report was completed
on 10 December 1980*



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Japan's Changing Relations With China and the USSR

Overview

Japan's tilt toward China and away from the USSR over the past decade portends a fundamental shift in the strategic equilibrium in Northeast Asia. Tokyo can no longer plausibly claim—as it did in the mid-1970s—to be pursuing an evenhanded policy toward the two Communist powers. Instead, Tokyo is steadily weaving closer ties with Beijing, while its relations with Moscow have cooled considerably.

Barring unexpected changes in the determinants shaping Tokyo's policy, Soviet-Japanese relations probably will remain cool through at least the mid-1980s. Sino-Japanese relations, on the other hand, probably will continue to grow stronger. On the assumption that this will take place in a context of continued coolness in US-Soviet relations, a healthy US-Japan alliance, and further improvement in Sino-US relations, the Soviet Union will find itself increasingly isolated in Northeast Asia.


This does not mean that Japan desires to align itself with China against the Soviet Union or to adopt an antagonistic stance toward that country. The Japanese Government believes that either policy would endanger national security and will be careful that the realignment does not proceed too far. Particularly in areas of Soviet sensitivity, Tokyo will resist pressure to make its policies conform to those of Beijing. Moreover, Japan is likely to experience frustration in its economic dealings with China and to retain a lively interest in stable, if not greatly expanded, trade with the USSR.

Nonetheless, Tokyo has decided that its policies cannot remain unaffected by the policies that China and the Soviet Union adopt toward Japan. China has demonstrated that it desires good relations with Japan, but the Soviet

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Union has been unwilling to take the steps that Tokyo believes are necessary to improve bilateral relations and objects to friendly relations between Japan and China. Moreover, the Soviet invasion of Afghanistan has heightened Japanese concerns about Soviet foreign and defense policies. As a result, Tokyo has decided to consolidate the link with Beijing and wait for Moscow to indicate an interest in negotiating a reasonable settlement of their outstanding issues.



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Contents

	<i>Page</i>
Overview	iii
Tilt Toward China	1
Hopes for Balanced Relations: 1972-74	1
Policy Paralysis at Mid-Decade	2
An End to Evenhandedness: 1978-80	2
Current Trends	3
Key Determinants of Japanese Policy	4
Strategic Considerations	4
Impact of Changing Relations Among the Big Powers	4
Role of Independent Japanese Judgments	6
Economic Considerations	7
Trade	7
Resource Development Projects	10
Political Considerations	15
Prospects	17
Continued Drift Toward Beijing	17
Alternative Scenarios	19
 Appendixes	
A. Japan's Trade With China and the USSR, 1970-79	22
B. Japanese-Supported Resource Development Projects in China and the USSR, 1970-79	23

Appendix Tables

A-1.	Japan's Trade With China and the USSR	21
A-2.	Japanese Imports of Fuels From China and the USSR	21
A-3.	Japanese Imports of Wood From the USSR	22
A-4.	Japanese Exports of Machinery to China and the USSR	22
A-5.	Japanese Exports of Steel to China and the USSR	22
B-1.	Officially Backed Japanese Loan Commitments Related to Resource Development Projects: USSR	23
B-2.	Japanese-Supported Resource Development Projects: USSR	24
B-3.	Possible Future Japanese-Supported Resource Development Projects: USSR	25
B-4.	Officially Backed Japanese Loan Commitments Related to Resource Development Projects: China	26
B-5.	Japanese-Supported Resource Development Projects: China	27
B-6.	Possible Future Japanese-Supported Resource Development Projects: China	28

Figures

1.	Japan's Trade With China and the USSR	8
2.	Japan's Imports From China and the USSR	9
3.	Japan's Exports to China and the USSR	10
4.	Japanese-Supported Resource Development Projects	12
5.	Japanese Loan Commitments Related to Resource Development Projects in China and the USSR	13
6.	Japanese Attitudes Toward the United States, China, and the USSR	16

Japan's Changing Relations With China and the USSR

Tilt Toward China

Japan's relations with the two Communist powers that dominate the Asian continent have undergone a fundamental change over the past decade. The process of change has moved through two distinct periods. The first covered approximately 1972-74, while the second began in 1978 and may not yet have concluded. At the beginning of the 1970s, the Japanese Government was attempting to maintain a reasonable balance in its approach to the two rival Communist states and had reason to hope that it could improve relations with both. By the end of the decade, the Japanese had succeeded in strengthening their ties with China, but relations with the USSR had deteriorated, and Tokyo could no longer plausibly claim to be pursuing an evenhanded policy toward the two powers.

Hopes for Balanced Relations: 1972-74

In the early 1970s, conditions appeared to the Japanese to be exceptionally propitious for a major improvement in their relations with both China and the Soviet Union. The United States' opening to China and the relaxation of US-Soviet tensions cleared the way for the Japanese to work out an accommodation of their own with the Chinese and to attempt an improvement in relations with Moscow. The restoration of diplomatic relations with China proved easy enough. Even before Tanaka became Japanese Prime Minister in July 1972, Beijing made it clear that it was prepared to negotiate a reasonable agreement.

The Tanaka-Chou Enlai Joint Statement of 29 September 1972 laid to rest the critical Taiwan issue that had blocked the normalization of relations.

Tanaka next moved to achieve a similar breakthrough on the Soviet front. Although diplomatic relations had been restored in 1956, Japan and the Soviet Union had never agreed on a peace treaty after World War II. The only obstacle to such a treaty was Moscow's

refusal to return four small islands north of Hokkaido—the so-called Northern Territories—that it had seized in the closing days of the war and that the Japanese consider an integral part of their homeland.

Tanaka apparently calculated that the prospect of rapidly warming relations between Japan and Moscow's Chinese antagonists would be sufficient inducement for the Soviets to think seriously about relaxing their grip on the disputed islands. In addition, the Soviets were displaying more interest in involving Japan in the economic development of Siberia. Part of Tanaka's strategy seems to have been to give the Soviets concrete incentives to come to terms on the territorial issue by cultivating their desire for large-scale Japanese participation in various Siberian resource development schemes. Immediately after his trip to China, the Prime Minister sent Foreign Minister Ohira to Moscow to prepare the way for him to make a visit to the Soviet Union, a trip viewed as the logical sequel to Tanaka's pilgrimage to Beijing.

The Tanaka-Brezhnev summit in Moscow in October 1973 proved to be the apex of Soviet-Japanese cordiality. Brezhnev spoke enthusiastically of the advantages both parties would derive from economic cooperation in Siberia; Tanaka responded positively and the following April released \$1 billion in Export-Import Bank credits for three large Siberian development projects. Tanaka also vigorously presented Japan's case for return of the Northern Territories. Although Brezhnev promised nothing, he held out the hope of flexibility by permitting the territorial issue to be included—if only implicitly—on the list of issues to be discussed during any future peace treaty negotiations.

Tokyo found the Chinese responding to its courtship of the Soviet Union with a two-track strategy. Beijing worked to sustain the momentum built up in the normalization process, cultivating allies throughout the Japanese political world, promoting rapid trade expansion, and professing a desire to press ahead on a treaty

of peace and friendship. At the same time, Beijing insisted that true friendship must be based on common principles—most notably the principle of opposition to efforts by third countries (i.e., the USSR) to establish hegemony in the Asia-Pacific area. Already enshrined in the 1972 Tanaka-Chou Joint Statement, this principle, the Chinese said, would have to be incorporated in any future treaty between the two countries.

The Soviet leadership apparently concluded that, in the long run, the USSR would lose more than it gained if it gave up the Northern Territories in return for a peace treaty. Moscow was not willing to moderate its position on the Northern Territories, even though it was anxious to obtain additional Japanese assistance in developing Siberia; the Soviets even asserted, with increasing vigor, that they had no intention of ever returning the islands. The USSR may have taken this hard line in part because it calculated that economic self-interest would prove stronger than nationalism, that the Japanese would not permit their desire for reversion of the islands to interfere with their access to Siberian resources, and that ultimately they would permit the territorial issue to fade away. At the same time that the Soviets forced the indefinite postponement of a Soviet-Japanese peace treaty, they also made clear that they would view as unfriendly and provocative a Japanese decision to sign a peace treaty with China that included an "antihegemony" clause.

Policy Paralysis at Mid-Decade

Bent on establishing good or at least businesslike relations with both the Soviet Union and China, Tokyo found itself in an increasingly awkward position and with not as much leverage or freedom of maneuver as it apparently believed it had when it embarked on its peace offensive in 1972. By 1976-77, the Japanese Government had reached an impasse. Tokyo's dilemma arose in part from the way in which it defined Japan's security and foreign policy interests. Prime Minister Fukuda summed up some of the most important policy goals in his call for an "omnidirectional, equidistant" peace diplomacy. This seemingly vacuous formula actually expressed a hardheaded assessment that it was in Japan's interest, first, to keep out of the Sino-Soviet dispute by maintaining an equidistant position between the two great Communist antagonists; and second, to adopt an accommodating, nonthreaten-

ing posture toward the outside world in general—but particularly toward the Soviet Union and China, the only countries that represent a potential threat to Japanese security.

With Moscow and Beijing each attempting to draw Japan to its side or, failing that, to ensure that Japan did not gravitate toward the other, Tokyo's determination to maintain an "equidistant position" mortgaged its policy to the Communist power least disposed to strengthen relations with Japan.

For several years, the situation remained frozen. If it changed at all, Japan's relations with both countries cooled.

The public also was gradually becoming more aware of the growing Soviet military presence in the Far East, and Japanese businessmen were discovering that dealing with the Soviets was more difficult than they had anticipated at the beginning of the decade. With regard to China, many Japanese were apprehensive that the growing strength of the radical "Gang of Four" might damage bilateral trade and presage a revival of antiforeign sentiment and the reappearance of some of the excesses of the Cultural Revolution.

An End to Evenhandedness: 1978-80

The stalemate in Japan's relations with China and the Soviet Union was broken by the purge of the Gang of Four in October 1976. The moderates who came to power emphasized modernization and thought that foreign assistance would accelerate the process. The Japanese believed the renewed Chinese interest in a treaty stemmed from the growing status of Deng Xiaoping—leader of the moderates—and his apparent belief that Japan could play an important role in China's modernization. That Deng, no less than those he supplanted, wanted to turn Japan against the Soviet Union did not in the end pose an insurmountable obstacle to Prime Minister Fukuda, because he had no intention of permitting Japan to be turned against anyone and because Deng proved sufficiently flexible to permit a compromise.

As the prospects for an eventual agreement between China and Japan improved, Moscow set about trying to derail the process. The approach that it chose emphasized threats and pressure and proved counter-productive. Official statements and propaganda directed toward Japan warned of unspecified dire consequences if Tokyo signed a treaty containing an antihegemony clause. Not coincidentally, at least in Japanese eyes, the Soviets began to strengthen their garrison in the Northern Territories, thereby underlining the ease with which their armed forces could be brought to bear against Japan and their determination to incorporate the disputed islands permanently into the USSR. The rhetorical threats and the military gestures took place against a backdrop of what the Japanese began to see as a steady and increasingly troublesome Soviet military buildup in the Far East.

The Japanese Government refused to be intimidated; on 12 August 1978 it signed a Peace and Friendship Treaty with China that bound both countries to oppose hegemony—as Beijing had insisted—but left each free to define its own position toward third countries—as Japan wanted. Tokyo was satisfied that the treaty did not commit Japan to concrete actions against the Soviet Union and stressed in its explanations to the Soviets that it had no intention of participating in an anti-Soviet cabal. At the same time, Tokyo felt little need to go beyond that assurance, when the USSR displayed so little interest in responding to Japanese desires and few inhibitions about trampling on Japanese sensibilities.

In general, the position taken by the Fukuda government may be summed up as follows:

- Although Japan would prefer to maintain a balance in its relations with China and the Soviet Union, its policies can no longer be unaffected by those that China and the Soviet Union adopt toward Japan.
- China has shown that it wishes friendly relations with Japan. If the Soviet Union not only is unwilling to take steps necessary to improve relations with Japan but objects to friendly relations between Japan and China, then so much the worse for the Soviet

Union; Japan will proceed to improve relations with China. If, however, the Soviet Union ever sincerely decides to pursue a rapprochement with Japan, it will find that Tokyo is ready to respond positively. In any case, Japan will not permit its China policy to be dictated by the Soviet Union, nor will it permit itself to be coerced.

- Despite any impression that Beijing may try to create about the character of the emerging Sino-Japanese relationship, Japan will not align itself with China against the USSR.

Current Trends

The trends in Sino-Japanese-Soviet relations already in evidence in 1978 were reinforced by the signing of the Peace and Friendship Treaty and, as of late 1980, are continuing in the same direction.

The strengthening of Japanese-Chinese relations was symbolically confirmed by Prime Minister Ohira's visit to Beijing in December 1979 and Premier Hua Guofeng's reciprocal trip to Tokyo in May 1980. This exchange of visits by the heads of the two governments—the first in the history of Sino-Japanese relations—together with Hua's attendance at Ohira's funeral in June, closed the cycle that Ohira, as foreign minister, had helped to open eight years earlier, when he set the stage for the 1972 Tanaka-Chou summit.

Before he died, Ohira made it clear to the Chinese that the time had come to move beyond sentiment and ritual to substance. The basic framework of treaties and agreements was in place. The governments of the two countries had met and held discussions at the highest levels. There were many indications that both sides were firmly committed to a sustained, long-term effort to consolidate friendly relations with one another. Now, Ohira asserted, Japan and China must give substance to the relationship, most importantly by expanding Sino-Japanese economic ties, and also by broadening the range of political issues that could be discussed frankly.

One sign of a more mature relationship, Ohira believed, would be a less compliant and more straightforward Japanese approach to China. Far from indicating a cooling of Japan's friendship with China, this would mark a transition to what Ohira described as true friendship, involving a recognition and tolerance of one another's shortcomings and of the differences of opinion that would be certain to arise.

Ohira demonstrated what he meant by stressing publicly that, although good relations with China were important to Japan, they would have to be conducted in the context of Japan's relations with other countries, particularly the member states of the Association of Southeast Asian Nations and the United States. Furthermore, although Japan would do its best to support the modernization of China's economy, it would not help with China's military modernization or support China's anti-Soviet policies.

The Chinese appear to have accepted Ohira's characterization of the spirit in which future Sino-Japanese relations should be conducted. To the extent that the two governments manage to act in this spirit, the chances that the relationship will prove resilient enough to absorb occasional setbacks will be enhanced.

A certain amount of distrust between Tokyo and Moscow was probably inevitable in the wake of the signing of the Peace and Friendship Treaty. Nevertheless, Tokyo clearly wished to contain the damage done to the Japanese-Soviet relationship and almost certainly would have tried to improve ties with Moscow had the Soviets not invaded Afghanistan, by coincidence only two weeks after Ohira returned home from his highly successful summit meeting with Hua.

The invasion has added new difficulties to Japan's relations with the Soviet Union—not that it has reversed or drastically altered existing patterns but it has accelerated and reinforced trends already in progress. Japanese antipathy toward and distrust of the Soviet Union have reached what may be postwar highs. Apprehension about Soviet intentions and about the implications of a militarily stronger USSR has intensified.

Union. All of these moves have intensified Soviet coolness toward the Japanese Government.

Tokyo will attempt to curtail this potentially dangerous trend. The new Suzuki government has already expressed interest in restoring a measure of normality to Japanese-Soviet relations. It has also taken the position, however, that if the Soviet Union wishes an improvement in relations it will have to take the initiative, not only on the longstanding territorial issue but also on Afghanistan. On neither issue have the Soviets conceded that there is even a problem to be discussed.

Key Determinants of Japanese Policy

Strategic Considerations

The evolution of Japan's relations with its two powerful Communist neighbors has been a product of a complex of interrelated forces. Among them, none has been more important than the shifting strategic equilibrium among the four major actors engaged in Northeast Asia.

Impact of Changing Relations Among the Big Powers.

Throughout the 1970s, the Japanese Government was fairly confident that at least two features on the international landscape would remain reasonably stable.

tent. Although in some ways this framework operated as a constraint on Japanese freedom of action, it also strengthened Japan's position in its dealings with Moscow and Beijing.

The government's second assumption was that Sino-Soviet relations would remain antagonistic or at least cool. The Japanese seem never to have believed that relations between China and the Soviet Union might heal sufficiently to permit the two rivals to coordinate their policies toward third countries. Since at least the late 1960s, therefore, Japan no longer has had to worry that its two most important potential enemies might join forces against it as they had in the early 1950s. This appraisal has greatly enhanced Japan's sense of security. In principle, it should also have increased Tokyo's ability to maneuver between the two Communist powers.

From the Japanese perspective, the seminal development that transformed relations throughout the four-power system was the Sino-US rapprochement engineered at the beginning of the 1970s.

Tokyo was aware that the hand of friendship that China was extending to Japan and the United States was guided by a calculated intent to isolate the Soviet Union. Tokyo also believed, however, that Washington intended to use improved relations with China to give the Soviets an incentive to improve their own relations with the United States. In the US scenario, detente along one axis would be the prelude to detente rather than confrontation along the other. US efforts to promote a relaxation of tensions with the Soviets not only provided Tokyo with a model that it found attractive—and certainly preferable to that of China's hostility toward Moscow—it also cleared the way for Japan to emulate that model. As in the case of Sino-Japanese ties, progress in improving Japanese-Soviet relations

no longer seemed likely to create stress in Japan's relations with the United States.

Even as the Japanese prepared to conclude the Peace and Friendship Treaty, they insisted that the completion of the normalization process with China should be considered a positive bilateral development with no significant negative implications for other countries. Tokyo seems to have calculated that once the treaty was signed Soviet antipathy toward Japan would prove short lived.

In retrospect, this estimate seems to have resulted partially from wishful thinking. It is now clear that Japan's growing relationship with China carries with it more substantial external costs than the Japanese probably expected or believe they should have to pay. Some Japanese suspect, for example, that the securing of China's Japanese flank may have helped free the Chinese to invade Vietnam, an act that helped Moscow strengthen its position in Hanoi.

Tokyo is also discovering that better Sino-Japanese relations are a persistent source of tension in Japan's relations with the Soviet Union. Even before Afghanistan, it was clear—especially to the Soviets—that the cumulative effect of a solid Japanese-US alliance, improving Sino-US relations, and the continuing consolidation of relations between China and Japan would be the coalescence of a trilateral entente. It was also clear that none of the three was well disposed toward the USSR and that each, with varying degrees of intensity, viewed that country as the principal threat to its security. Thus, the Soviet leadership had good reason to suspect that an anti-Soviet coalition was in the making. If such a coalition jelled into the equivalent of an alliance, the national security interests of the USSR would be gravely affected. Hence the unremitting Soviet effort to warn all concerned—particularly Japan, the weakest and most susceptible to intimidation—that it would view with alarm further movement in that direction.

Nevertheless, the Soviet Union invaded Afghanistan. In this case it seems to have been the Soviets who miscalculated the effect of their actions on others. The United States is increasing defense spending, pressuring its allies—including Japan—to follow suit, and opening the door to the transfer of nonlethal military equipment to China.

Although the extent of the Japanese reaction can be overdramatized, there is no doubt that the invasion had a strong effect and helped alter the terms of reference of the domestic debate on security and foreign policy issues.

As for China, it has applauded the reaction in the United States and Japan and has invited the two countries—somewhat to their embarrassment—to join with it in a worldwide anti-Soviet united front. By invading Afghanistan, the Soviet Union has given a powerful impetus to those trends in US-Japan-China relations that it finds most disturbing.

Role of Independent Japanese Judgments.

Moreover, actions by the United States, China, or the USSR often seem to have a controlling influence over Japanese policy. Nonetheless, this is not an adequate explanation of developing Japanese policy toward China and the Soviet Union.

Japan has its own interpretation of where its strategic and foreign policy interests lie, and the broad outlines of the policies it has devised to protect these interests are clear. First, the Japanese Government believes more strongly now than 10 years ago that Japan must maintain strong, friendly relations with the United States. This has implications for how Japan will manage its relations with China and the Soviet Union:

- The Soviets must not be afforded opportunities to foment discord between Japan and the United States.
- Japan must not submit to Soviet pressure to weaken its security ties with the United States.
- If relations between the United States and the Soviet Union deteriorate, in general Japan should side with Washington.
- China must not be permitted to become a source of rivalry and distrust between Japan and the United States. Japan should work with the United States to develop a cooperative approach to Beijing.

Second, the Japanese are convinced that their long-term strategic interests are best served by maintaining good relations with China. The Japanese do not want ever again to be in conflict with China, or even to be estranged from that country, as they were during the Cold War. Being on good terms with China not only creates a less threatening security environment, it also frees Japanese attention and resources for other problems. In support of this objective, Tokyo has devised several mutually reinforcing policies:

- It has mounted a broad, sustained effort to cultivate the trust and good will of the Chinese leadership.

- It has avoided pressing for the resolution of potentially contentious issues.
- It has given evidence that it wishes to be as supportive as possible of the Chinese modernization effort.
- It has demonstrated its commitment to establishing closer Sino-Japanese relations by resisting strenuous Soviet opposition to that process.

Over the longer term, the Japanese apparently hope that these measures will help to strengthen the position of the relatively moderate elements in Beijing that Tokyo believes are most likely to want to remain on good terms with Japan. At the same time, there can be no guarantee that future Chinese governments will always be as friendly toward Japan as the current one is. The consequence for policy is that Tokyo will not directly support the modernization of the Chinese military establishment and has serious reservations about the wisdom of US policies that might serve that end.

Third, the Japanese are determined to ensure that Tokyo and Moscow never come into conflict or even drift into a situation in which a possibility of conflict exists; Tokyo is mindful that the Soviet Union could easily destroy Japan. A policy in support of this interest has been more difficult to devise. In general, Tokyo has tried to implement two seemingly contradictory but actually balanced policy lines. First, it has:

- Sought to reassure Moscow that Japan has no hostile intentions toward the Soviet Union and will not join with third countries in hostile actions against it.
- Tried to show that it is willing to cooperate on a businesslike basis with Moscow's effort to accelerate the economic development of Siberia.
- Maintained that it is ready to conclude a peace treaty as soon as Moscow returns the Northern Territories.

At the same time, Tokyo has made clear that it is not wholly passive. It:

- Acquired through the Mutual Security Treaty with the United States a deterrent against the perceived Soviet threat.
- Created armed forces of its own to supplement, and enhance the credibility of, the treaty.
- Has persisted in pursuing good relations with the two most threatening potential enemies of the Soviet Union.

- Has become less inhibited about expressing its displeasure with, and taking countermeasures against, Soviet actions deemed detrimental to Japanese interests.

Economic Considerations

A widespread assumption exists that Japanese foreign policy is dominated, if not determined, by a drive for economic advantage. In the case of relations with China and the Soviet Union, however, broad strategic considerations not only have played a more potent role in shaping major policy decisions, but have exerted a strong influence over the manner in which many apparently unrelated activities—including economic—have been conducted.

Nonetheless, Japanese decisionmakers have been sharply attuned to economic considerations, which have influenced their view of how, and for what purposes, Japan should approach the Soviet Union and China.

Trade. The trading relationship between Japan and the two Communist powers has been based on an exchange of Chinese and Soviet energy resources, raw materials, and relatively unsophisticated manufactured goods for Japanese steel, machinery, and whole plants.

In the case of China, Japanese imports and exports have followed roughly parallel lines and have moved through two periods of rapid increase, from 1973 to 1975 and from 1978 to the present (see figure 1).¹ The growth curves for Sino-Japanese trade generally have followed those for China's overall foreign trade; both have tended to respond to economic and political developments within China.

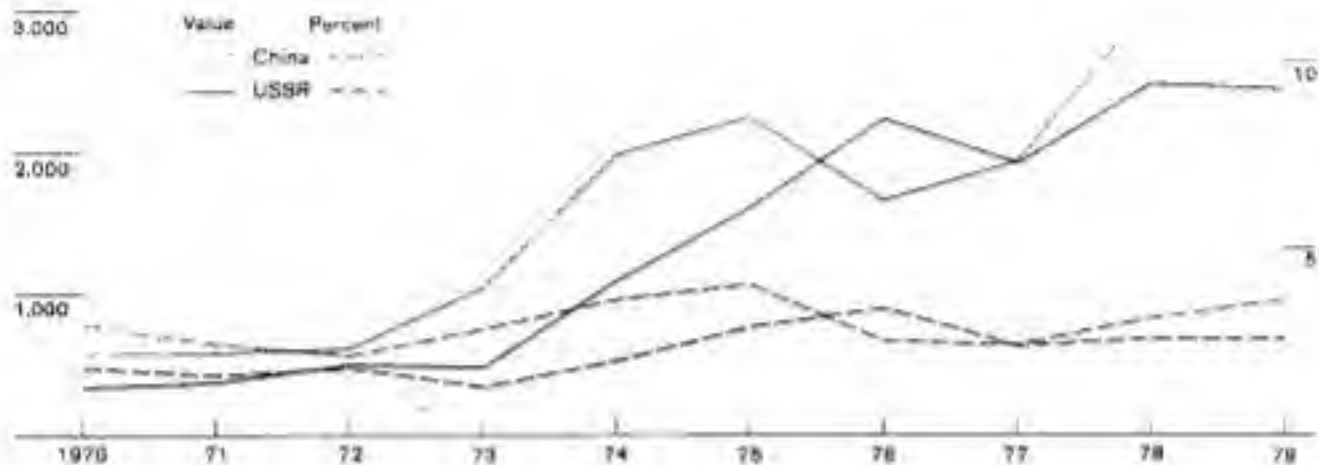
In the case of the Soviet Union, imports grew rapidly in 1973 and 1974 and then leveled off. Similarly, exports expanded between 1974 and 1976 and then slowed. The two bursts of activity in Sino-Japanese trade coincided with major political breakthroughs in bilateral relations, and the upsurge in Japanese-Soviet trade occurred during the years when bilateral relations were relatively good.

¹ Data on Japan's trade with China and the Soviet Union are provided in appendix A.

Figure 1: Japan's Trade With China and the USSR**Exports**

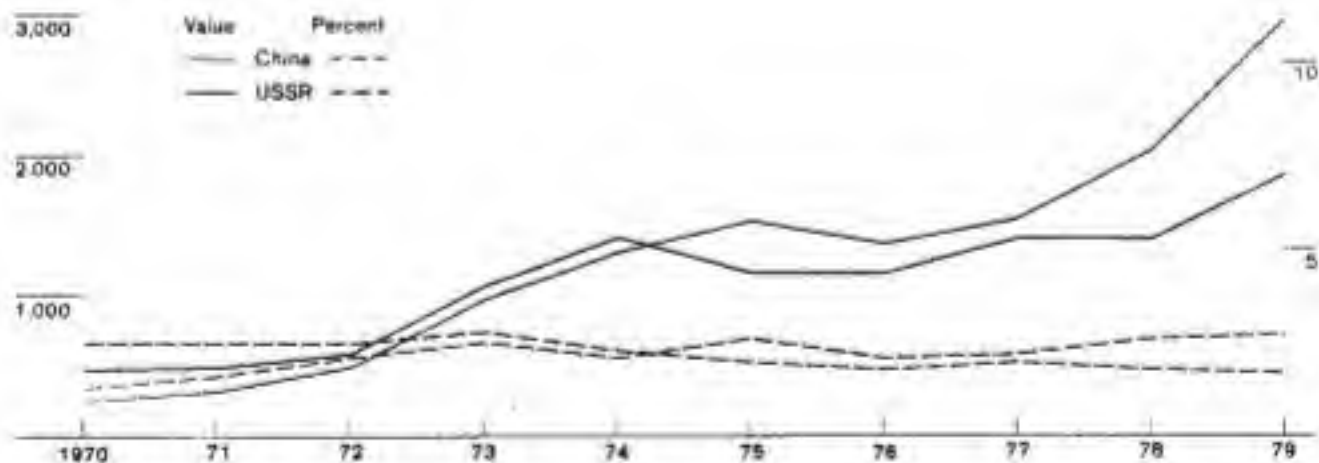
Million US Dollars
4,000

Percent of Total
Exports
15

**Imports**

Million US Dollars
4,000

Percent of Total
Exports
15



China generally has been the more important trading partner for Japan. In every year but 1976, the value of Japan's exports to China exceeded that of its exports to the Soviet Union. In every year since 1975, imports from China have been greater than those from the USSR. In the past two years, the gap between the two countries in both categories has widened dramatically.

As impressive as the rates of growth in bilateral trade have been in some years, Japan's trade has expanded so rapidly that the percentages of the total accounted for by China and the Soviet Union have remained low. The Soviet share of Japanese imports has been about 2 percent for the past six years and has been declining; China's share is growing but is still below 3 percent. The proportion of Japanese exports accounted for by the two countries is only slightly larger: about 2.5 percent for the Soviet Union, below 4 percent for China.

In assessing the extent of Japan's dependence on China and the USSR it is necessary to examine the commodity composition of the two countries' trade with Japan (see figure 2). Japanese imports from China and the USSR are dominated by raw materials. In the critical energy sector, Japan has not been dependent on either country for a large enough proportion of its requirements to give either China or the USSR significant economic or political leverage over Japan.

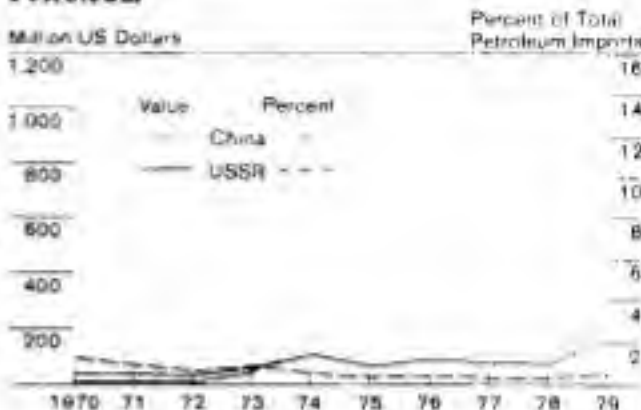
Since 1974, the value of Japan's petroleum imports from China has grown rapidly, yet China's share of Japan's total petroleum imports has remained low and stable at 2 to 3 percent. Japan obtains even less of its petroleum from the Soviet Union.

The relative position of the two Communist powers is reversed when it comes to coal; Japan has drawn much more of its coal from the USSR than from China. The value of imports from China, however, is increasing, while that from the Soviet Union is declining. The Soviet share of Japan's total coal imports, although not insignificant at 4 to 5 percent, has not been impressively large.

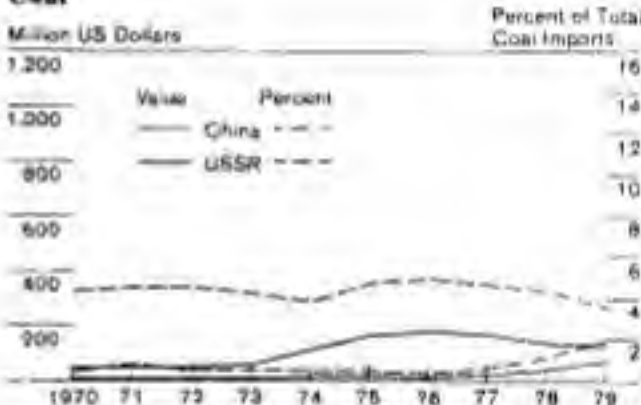
The one commodity that looms large in Soviet exports to Japan, and which implies a degree of Japanese dependence, is timber. Although the Soviet share fell

Figure 2: Japan's Imports From China and the USSR

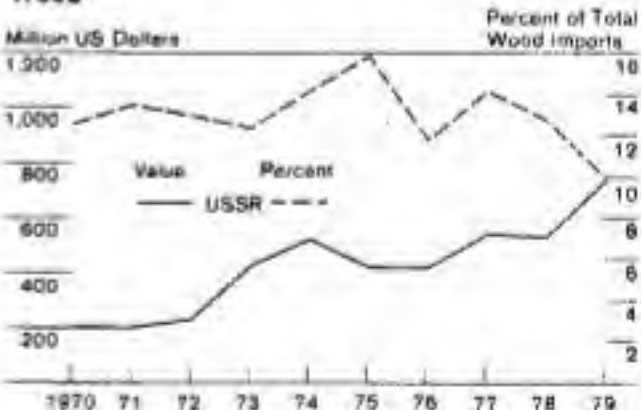
Petroleum*



Coal



Wood



*Includes crude petroleum and petroleum products

to 10 percent in 1979, for most of the past decade Soviet timber has accounted for between 12 and 16 percent of Japan's timber imports. Japan obtains no timber from China.

Japanese businessmen consider the Soviet Union and China to be important export markets. Although their respective shares in total Japanese exports have been small, the Japanese believe the long-term potential for a rapid increase in demand for Japanese technology, equipment, and steel is large. Moreover, these markets have taken on greater importance as recession in the West has lowered the demand for such goods (see figure 3).

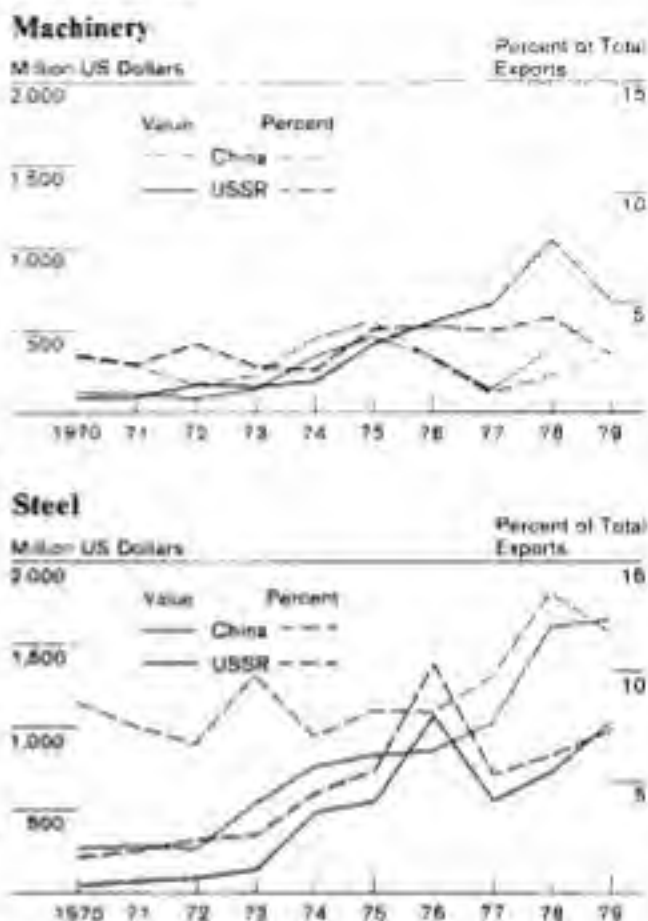
The two most prominent commodity categories of Japanese exports to China and the USSR are steel and machinery. In machinery, the Soviet Union has proved to be the larger and more stable market; exports to China have oscillated in response to shifts in Beijing's foreign trade and modernization policies. In 1979, however, the gap between the two almost closed. In four of the past five years, machinery exports to the USSR represented 4 percent of total Japanese shipments—enough to be favorably noted by Japanese businessmen and officials.

With almost 20 percent of Japanese steel exports going to China and the USSR in 1979, a degree of export dependence seems to have developed in steel. In this area China ranks first, with imports from Japan growing steadily, reaching a value of more than \$1.5 billion and accounting for more than 11 percent of Japanese steel exports in each of the past two years. Exports to the Soviet Union are also substantial, representing 5 to 7 percent of total steel exports for the past five years (except for 1976, when they jumped to 10 percent). Japanese steelmakers, therefore, can by no means afford to ignore these markets.

Resource Development Projects. An important aspect of Japan's effort to promote expanded trade with the two Communist countries has been Tokyo's support for resource development projects in both China and the USSR.

¹ Additional detailed information on these projects is provided in appendix B.

Figure 3: Japan's Exports to China and the USSR



A basic component of Japan's long-term economic strategy is a continuing worldwide search for fuels and raw materials. Two key elements of this process are an effort to diversify Japan's sources of supply and a readiness to provide the credits, capital goods, and technology necessary to develop new mines, oilfields, and timber deposits.

The trade data suggest that, in general, China and the Soviet Union have not emerged as important sources of supply. Nevertheless, so massive are Japan's requirements that the joint projects it has negotiated, first

with the Soviet Union and more recently with China, are from their points of view impressive in scope and represent badly needed sources of foreign exchange (see figure 4). [REDACTED]

The first requirement of resource development projects has always been credit. The projects tend to have lengthy gestation periods and to be very expensive, and prospective partners often have been able to expand production to meet Japanese needs only when Japan has been willing to finance a major share of the costs. China and the Soviet Union have been no exception. [REDACTED]

In 1968, long before Beijing was willing to permit foreigners to participate in joint projects, Moscow negotiated its first resource development contract with Japan. The formula devised became the prototype for all subsequent bilateral compensation agreements. Japan supplied \$163 million worth of machinery, equipment, and consumer goods backed by Export-Import Bank credits and in return received a portion of the natural resources that were developed—in this case, logs and timber for Japan's housing industry. A second agreement followed in 1971, calling for \$50 million in Japanese equipment in return for manufacturing pulp and wood chips for the Japanese paper industry. In addition, in 1970, the Japanese put together an \$80 million package that permitted the expansion of Vostochnyy Port near Nakhodka so that it could handle a larger volume of coal and timber exports to Japan. [REDACTED]

It was not until 1974-75, however, when Tokyo made its first large-scale, government-to-government loans to the Soviet Union, that the process got under way in earnest. In a highly political gesture, Japan's Export-Import Bank released more than \$1 billion in credits—\$550 million for equipment for a second major timber project, \$450 million for developing the Chul'man coal field in South Yakutia, and \$25 million toward the cost of the initial exploration phase of a possible multi-billion-dollar effort to exploit Yakutia's natural gas deposits. In addition, Japan committed \$152 million to exploration for Sakhalin offshore oil and gas—with repayment dependent upon discovery of oil. Much of the expansion in bilateral trade that took place in subsequent years was fueled by these loans (see figure 5). [REDACTED]

In the Soviet Union (and later in China), the Japanese often became deeply involved in the development process, although they were permitted only a limited on-site presence and no equity participation. In the case of Siberian timber, for example, Japan provided:

- Assistance in project planning and execution.
- The machinery necessary to reach and cut the timber and transport it to a rail line or river.
- Plants for processing some of the timber into pulp, wood chips, or lumber.
- Equipment and technology necessary to expand port-handling capacity.
- Ships to carry the timber and timber products to Japan.
- Consumer goods to lure Soviet workers to work on the project. [REDACTED]

None of these ventures would have materialized had Japanese businessmen and officials not been convinced that they were profitable and consistent with the broad, long-term economic interests both of the relevant industries and of the country as a whole. At the same time, however, the government also hoped that the ventures would demonstrate Tokyo's good will and help promote an improvement in bilateral relations—possibly even inducing the Soviets to discuss the vexatious territorial issue. [REDACTED]

Since 1974-75, Japan's interest in Siberian development seems to have waned. All of the credits released since then have been supplementary to agreements made earlier:

- Two additional loans for equipment for South Yakutsk coal—\$90 million in 1977 and \$40 million in 1979—bringing the total for the project to \$580 million.
- In 1979, a second \$70 million loan for Sakhalin oil and gas exploration, raising the total for the project to \$222 million.
- Agreement on a large-scale timber development deal is expected to be reached soon; this will represent the third phase of a project that has been under way since 1968. [REDACTED]

No wholly new projects have been undertaken. Moreover, the giant Yakutsk natural gas venture seems certain to go the way of the abortive Tyumen oil pipeline scheme. Existing projects will be continued

Japanese-Supported Resource Development Projects in China and the Soviet Union

Figure 4

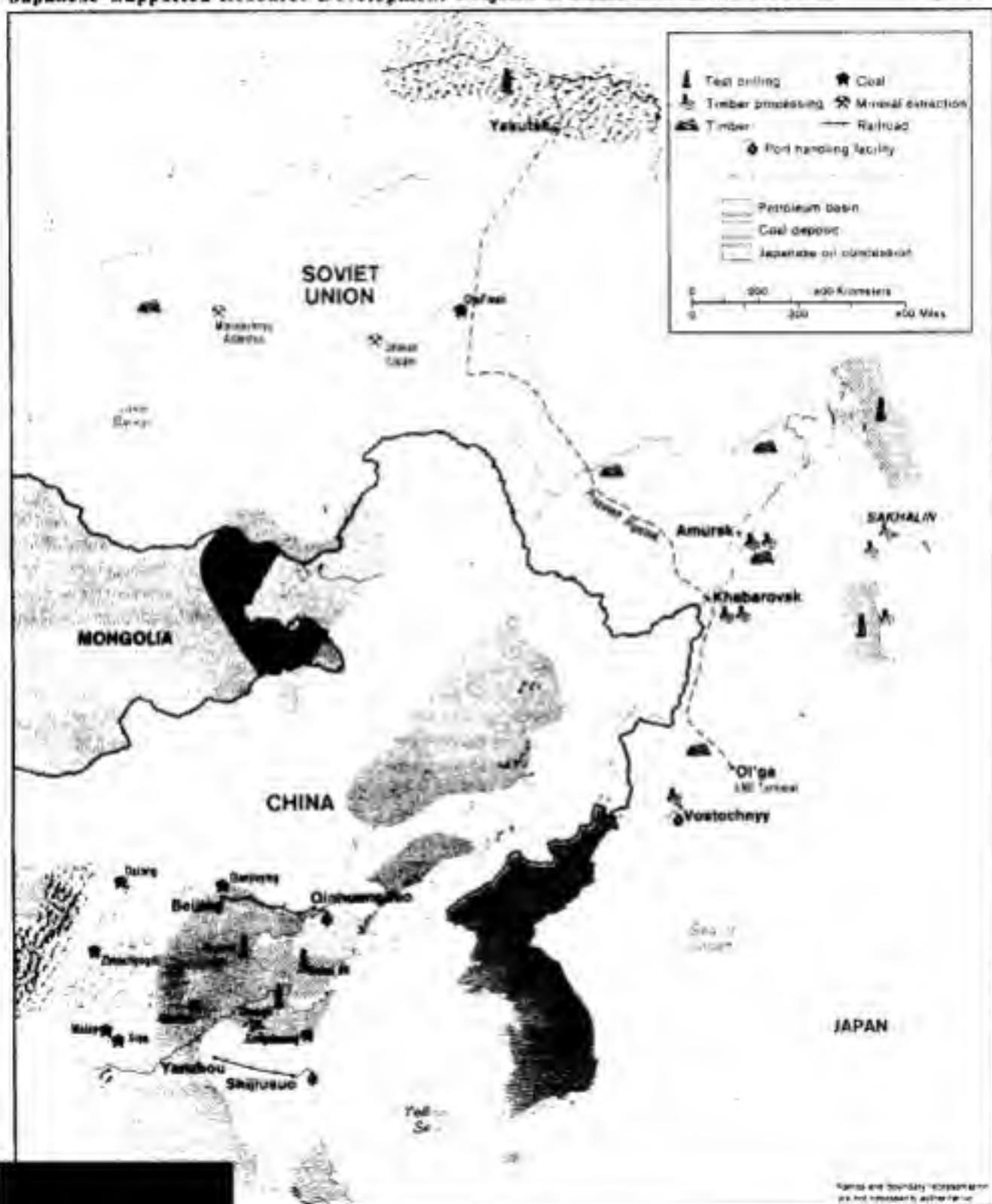
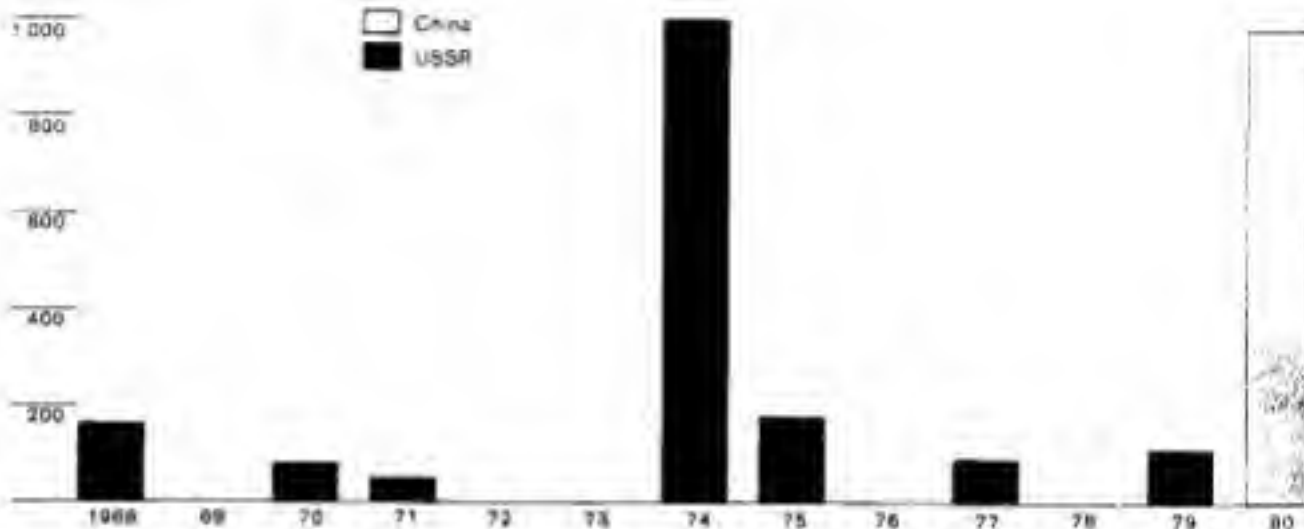


Figure 5: Japanese Loan Commitments Related to Resource Development Projects in China and the USSR

Million US Dollars

1,200



and perhaps expanded, but no dramatic departures appear to be in the offing. ■

Both sides had their reasons for not pressing ahead with new resource deals. The Soviets have moved more slowly in recent years, both in expanding trade with the West and in negotiating joint projects in Siberia. The rapid growth of Moscow's debt in the mid-1970s forced a more cautious approach for a time. Moreover, problems in installing and operating the large amount of imported equipment led to a sharp drop in orders from the West. ■

Japan has been reluctant to move further ahead in Siberia for both economic and political reasons. Siberia's severe climate, great distances, and perennial

labor shortages are serious obstacles to profitable development. Moreover, the Soviets have proved to be difficult business partners. They have sometimes overplayed their hand, apparently convinced that the Japanese, hungry for the resources that Siberia has to offer, will ultimately accept Soviet terms. But Japanese entrepreneurs are used to operating in a global economic arena and evaluate Siberian resource development projects in light of the alternatives. During the late 1970s, Japanese businessmen seem to have calculated that it would be more prudent and profitable to pursue diversification elsewhere. Nevertheless, they have kept the door open by continuing at least to discuss new projects with the USSR. ■

The gradual deterioration of political relations during these same years also seems to have affected Tokyo's willingness to back ambitious new projects in Siberia. Japan's political and bureaucratic leaders evidently saw little strategic incentive for promoting ventures that were often questionable economically and that would increase the country's dependence on the Soviet Union at a time when Moscow seemed increasingly unfriendly and oblivious to Japanese hopes for Soviet flexibility in the political arena. The Soviet invasion of Afghanistan reinforced this perception.

The Chinese did not finally decide that it was in their interest to invite Japanese involvement in resource development until 1979-80. The change in policy was a consequence of two converging imperatives. First, having decided to step up the pace of modernization by importing more foreign technology, machinery, and whole plants, the Chinese leadership had to devise means of earning more foreign exchange. Among the most promising options was to greatly increase their exports of coal and petroleum, both of which could find a ready market in Japan. If the Japanese could be persuaded to provide the credits necessary to expand oil and coal production, this would help Beijing manage a second problem—meeting China's own burgeoning energy requirements. Beijing also may have been receptive to Tokyo's overtures because the Japanese were willing to help remove the transportation bottlenecks impeding the expansion of China's export capacity and because they offered generous financial arrangements—easier in terms of interest rates and repayment periods than those granted the Soviets and easier than those offered China by other Western nations.

As in the case of its ventures in the Soviet Union, Tokyo's position on resource development projects in China has been the product of a complex of political and economic considerations. Political objectives seem to have weighed more heavily in shaping the Japanese approach toward China, however, most obviously in Tokyo's decision to extend aid in the form of long-term loans at highly concessional interest rates. Tokyo evidently hopes that this aid and the expanded exports it will permit will not only help to cement closer bilateral relations but will support, if only indirectly and marginally, stability in China. The Japanese believe

that the current leadership in Beijing is more likely than any other to discern the benefits for China of building a stable, friendly relationship with Japan and—in spite of the invasion of Vietnam two years ago—is less likely to lead China into dangerous foreign adventures that might disrupt its modernization process.

Resource development agreements concluded with China this year also are intended to serve definite economic objectives. The Japanese see China, like Siberia, as a promising alternative source of supply for the energy resources Japan needs. The Long-Term Trade Agreement (LTTA), signed in February 1978, envisaged a rapid expansion in bilateral trade based on a rapid increase in Chinese oil exports. In May 1979, when it began to appear that the Chinese would not be able to raise the capital necessary to expand their oil production, Tokyo approved a \$2 billion line of credit from the Export-Import Bank to develop China's capacity to produce and export energy resources.

The focus of the joint effort in the petroleum sector is the offshore fields in the Bohai Gulf. In May 1980, final agreement was reached on a \$485 million Export-Import Bank loan that the Chinese could use to cover their half of development costs. Since this sum is to be matched by the Japanese investors participating in the venture, almost \$1 billion in Japanese capital has already been committed to this one project.

Beginning in 1979, however, Beijing began to suggest to the Japanese that it might not be able to sustain the rate of increase in oil exports to Japan called for in the LTTA, that, instead, oil exports probably would level off, and that it might take longer than anticipated to bring the Bohai field into production. Meanwhile, the Chinese stressed, until new oil became available, coal offered the best hope of fostering further increases in Japan-China trade.

China's failure to fulfill the promises it had made in 1978, owing largely to excessively optimistic oil-production forecasts made in the mid-1970s, came as a disappointing setback to those Japanese who had been at the forefront of the effort to promote a major expansion in bilateral trade. Together with other commercial difficulties encountered at this time,

Baikal, the 11 coal-related projects are concentrated in a small area around Bobai, which is also the location of the Japanese oil exploration effort. [REDACTED]

Political Considerations

Many of the events and trends outlined above filter through, and are distorted by, the domestic political process, from which they return to the decisionmakers, often in narrowly focused, idiosyncratic, emotion-laden forms. Two closely related key points need to be made in this connection, one related to general Japanese perceptions of the Soviets and Chinese, the other to Soviet and Chinese access to the Japanese political system. [REDACTED]

Public attitudes appear to have undergone dramatic changes over the past 20 years (see figure 6). During the 1960s, 30 to 50 percent of the Japanese disliked both countries. Less than 5 percent liked one or the other. With the advent of detente, however, dislike of China and the Soviet Union declined. In the case of China, negative perceptions plummeted in the wake of the euphoria surrounding the restoration of diplomatic relations, and increasing numbers of Japanese apparently came to hold positive sentiments toward Beijing. No comparable upswing in liking for the Soviet Union occurred. [REDACTED]

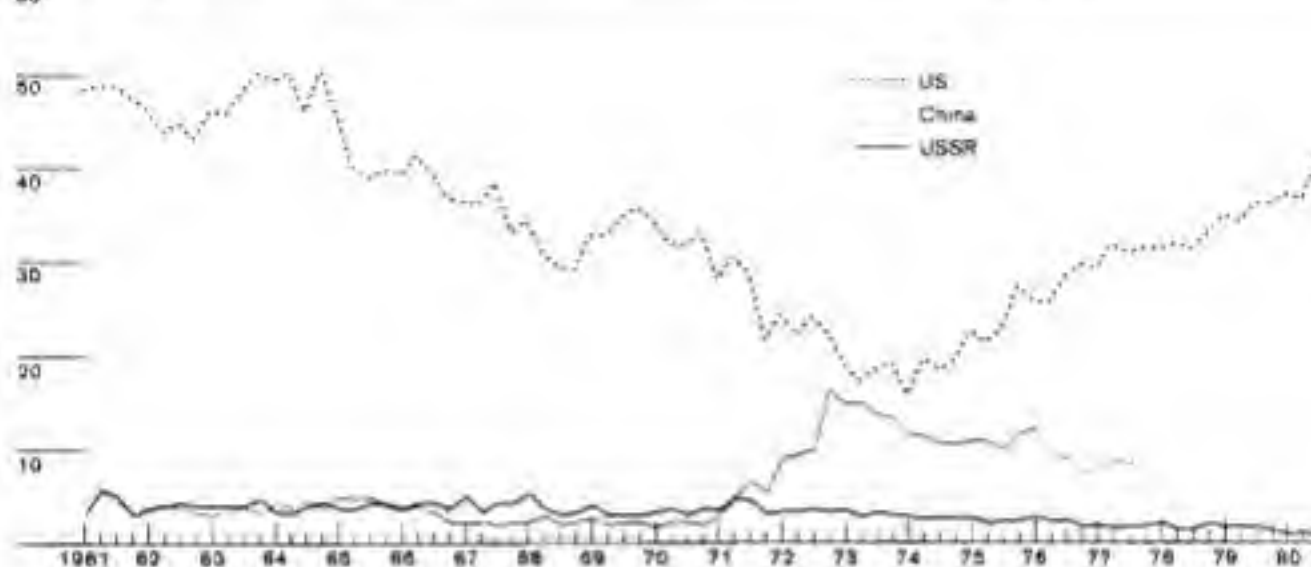
The most striking development to take place after the shift in opinion in the early 1970s was the increase in public dislike for the Soviet Union in the later years of the decade: in the year since Afghanistan, it has risen to unprecedented heights. Thus, at the beginning of the 1980s, the Japanese public is far more favorably disposed toward China than toward China's adversary. [REDACTED]

The two ports, two railroads, and seven coal mines are mutually dependent and reflect what appears to be an integrated development strategy designed to expedite the flow of coal to Japan. Unlike the Japanese-supported resource development projects in the Soviet Union, which are scattered across Siberia east of Lake

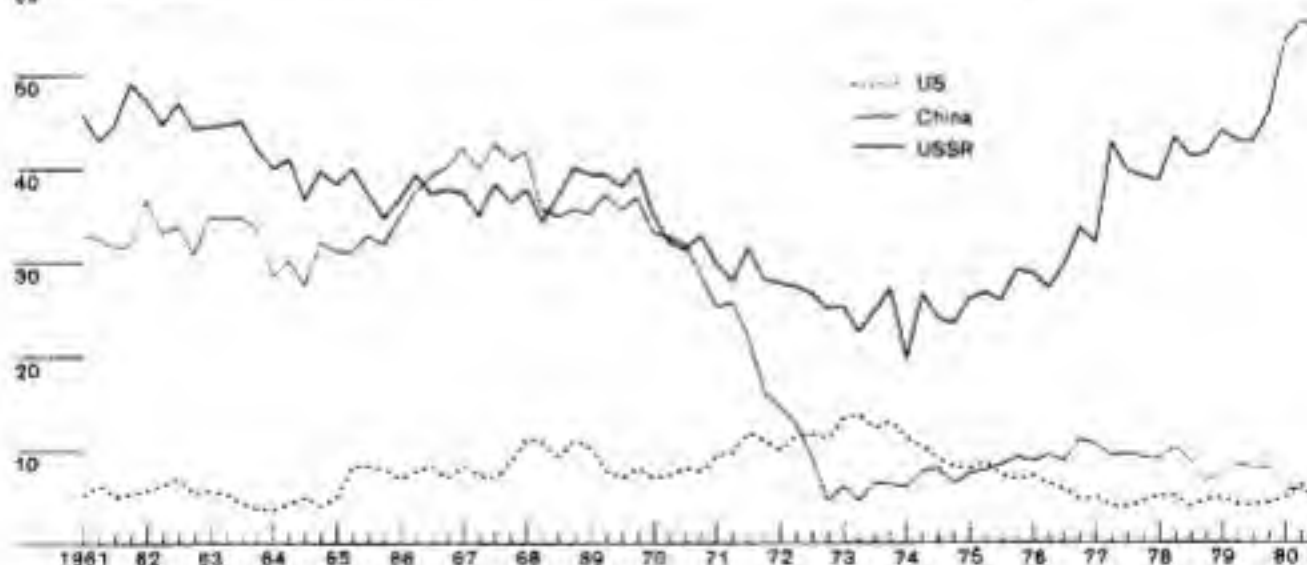
The Chinese have found it much easier than have the Soviets to penetrate and influence the Japanese political system. The Japanese people are highly conscious of the extent to which Chinese civilization has influenced their own culture—intellectually, artistically,

Figure 6: Japanese Attitudes Toward the US, China, and the USSR*

Percent Most Liked



Percent Most Disliked



* Data points are quarterly averages based on responses to identical questions posed over a 20-year period in the monthly nationwide poll conducted by the Jij Press. Those polled were asked to select from a list of countries the three that they most liked and the three that they most disliked.

linguistically, and in terms of social, political, and religious norms. The Japanese also appear to respond positively to the fact that the two peoples are of similar racial stock. Overall, this respect and affinity for China affects current Japanese attitudes. In addition, many people feel residual guilt about Japan's aggression against China in the 1930s and 1940s. [REDACTED]

In general, therefore, the Japanese public is more likely to be sympathetic toward Chinese points of view and more willing to be persuaded that they are worth serious consideration. The Chinese have recognized the opening this has given them and for 30 years have supported a sophisticated campaign to build support in Japan and persuade the Japanese to back positions favored by China. [REDACTED]

Except for the steadily shrinking minority of Japanese who still look to the Soviet Union as the chief defender of world socialism, few Japanese feel any bond—sentimental, cultural, or otherwise—with the USSR. On the contrary, most Japanese strongly dislike Communism—particularly the Soviet variety—and are aware of their country's historic rivalry with the Russian Empire. What respect there is tends to be directed at the Soviet military—and here the respect is colored by fear. Far from feeling guilt toward the Soviet Union, the Japanese harbor a sense of grievance for Moscow's last-minute entry into World War II and its annexation of what they regard as Japanese territory. The Soviets have not attempted a campaign similar to that mounted by Beijing, possibly because they have realized that in such a climate no comparable opportunity existed for them. To the extent that they have tried to intervene in the Japanese political process, their approach has generally been crude and counter-productive. [REDACTED]

From the perspective of the Japanese decisionmaker, efforts to strengthen relations with China will thus tend to be popular, while similar efforts to improve relations with the Soviet Union are likely to yield more limited political rewards. Given the recent increase in popular antipathy toward the Soviets, Japanese politicians may be more inclined to adopt a firm position toward the USSR, while they will tend to view opposition to close Sino-Japanese relations as a liability. [REDACTED]

Prospects

Continued Drift Toward Beijing

Tokyo's drift toward China and away from the Soviet Union appears to have gathered considerable momentum. Barring unexpected changes in the complex of determinants shaping Tokyo's policy, Soviet-Japanese relations probably will remain cool through at least the mid-1980s; they may even deteriorate further. Sino-Japanese relations, on the other hand, probably will continue to grow stronger. [REDACTED]

On the assumption that this will take place in a context of continued coolness in US-Soviet relations, a basically healthy US-Japan alliance, and further improvement in Sino-US relations, the Soviet Union will find itself increasingly isolated in Northeast Asia. If, as seems likely, Moscow attempts to arrest this development by resorting to the same heavyhanded methods it has used in the past, it will only reinforce the process, which has come to be sustained by the shared concern of the other three powers about Soviet behavior and intentions. [REDACTED]

This does not mean that Tokyo desires to take sides with Beijing against the Soviet Union—much less conclude an alliance with China or adopt an antagonistic stance toward the USSR. The Japanese are convinced that either policy would endanger national security, and they will be careful to ensure that the realignment does not proceed too far. Should there be signs of an incipient crisis in Soviet-Japanese relations, Tokyo will do its best to avert it. By the same token, while Tokyo is likely to invest considerable effort in further consolidating Japan's relationship with China, it will also maintain a certain distance from the Chinese. It will resist pressure to conform its policies to those of Beijing, particularly in areas of Soviet sensitivity. For at least the next few years, it is not likely to cooperate, except indirectly, in China's military modernization program or to permit its defense officials to go beyond limited contacts with their Chinese counterparts. In addition, the Japanese have concerns of their own about what a militarily powerful China might portend for their security. [REDACTED]

Japan also is bound to experience considerable frustration in its future economic dealings with China and to retain a lively interest in the economic benefits of stable, if not greatly expanded, trade with the Soviet Union. [REDACTED]

Siberian oil and gas, coal, and timber will be in demand in Japan for the indefinite future, and a desire to retain and expand access to this source of supply will inhibit the government from taking steps that it believes might seriously alienate Moscow—including taking the lead in enforcing a severe sanctions policy against the Soviet Union. In addition, the Japanese consider the USSR a valuable market for exports of technology, machinery, whole plants, and steel products. The government has backed these exports in the past with Export-Import Bank credits and is likely to continue to do so, particularly if slow growth in the West limits Japanese sales in these markets. On the other hand, to the extent that bilateral relations cool, Tokyo is likely to become more cautious about increasing its financial stake in the Soviet Union or becoming dependent on that country for too large a share of its requirements for imported fuels and raw materials. [REDACTED]

Barring a serious deterioration in bilateral relations, Tokyo will approve Japanese participation in the exploitation of Sakhalin offshore oil and gas resources. [REDACTED]

[REDACTED] If, as now seems likely, Japanese businessmen decide that it is worthwhile to proceed to the production phase, Tokyo probably will approve the project. Although this could turn out to be larger than any of the joint resource development ventures negotiated thus far, the volumes of oil and gas delivered to Japan still would not be large enough to create a significant degree of energy dependence on the Soviet Union. For strategic and economic reasons, Tokyo would insist that any imports of Soviet natural gas be delivered in liquefied form by tankers rather than through a pipeline to Hokkaido. [REDACTED]

In any case, given the present stage of the various joint resource development projects, it is unlikely that exports of Soviet natural resources could increase substantially before the mid-1980s because:

- Prospects for the development of Sakhalin oil and gas seem promising but full-scale production is not likely before 1985.
- Agreement—anticipated in early 1981—to proceed with a third timber project will ensure continuity in shipments of timber products to Japan, but at roughly the same levels as in the past. (S NF NC)

What might cause Tokyo to review the bidding on Siberian resource development projects would be a deepening of the crisis in world energy supplies. One possibility that already may be under consideration would be to accept the steam coal overburden currently being stripped from the Chul'man coking coal scheduled to be exported to Japan. Another and more significant possibility is that the Japanese could decide to go ahead with the large Yakutsk natural gas project without US participation. Here again, however, large-scale deliveries of steam coal probably would not begin until the mid-1980s or of gas until the later years of the decade. [REDACTED]

Nevertheless, Tokyo's commitment to support China's modernization effort is not likely to be shaken, and Japan's trade with China probably will continue to be larger than that with the USSR. Moreover, by 1985 China is likely to be exporting more oil and coal to Japan than will the Soviet Union. ■

If Japan continues to move toward China and away from the Soviet Union, and if the incipient Japan-China-US entente continues to coalesce, US interests will be affected in two principal ways:

- Tokyo will be likely to persist in its effort to strengthen its defense ties with the United States and increase its conventional military capabilities by accelerating implementation of its midterm defense plan.
- Moscow, for its part, is likely to perceive these developments as threatening, or at least damaging, to Soviet interests and might initiate countermeasures in other regions or on other issues that would adversely affect US interests. ■

Alternative Scenarios

Japan will continue to drift toward China and away from the USSR unless one or more of the major assumptions in this study prove wrong. Among these assumptions, perhaps the most critical involve future Soviet and Chinese policies toward Japan. ■

This paper has assumed that China's policy toward Japan is basically a function of, first, Beijing's strategy for dealing with the perceived threat from the Soviet Union and, second, its strategy for accelerating modernization. Of the two, the second is probably the most susceptible to change. Given the magnitude of the task that China's current leadership faces over the next few

years, it is possible that a series of overlapping and reinforcing failures could generate social, economic, and political stresses sufficiently serious to cause a breakdown in the modernization program and provoke a major leadership crisis. Inevitably, one result would be a blow to Chinese foreign trade and Sino-Japanese economic relations, as well as to Chinese economic growth. If the domestic Chinese crisis spills over into the foreign policy arena, as similar crises have in the past, Japan's overall relations with China could become seriously strained. If the Japanese found their friendly overtures being rejected by a more xenophobic, fundamentalist breed of Chinese leaders, they might be less forbearing and understanding than they have been in the past. In any case, the current trend toward stronger, more cordial bilateral relations would be reversed. ■

It is more difficult to sketch a plausible scenario involving a change in Soviet policy toward Japan that would be substantial enough to slow, much less reverse, the trend toward increased tension in bilateral relations. From the Japanese perspective, there are two principal problems: Moscow's refusal to settle the territorial issue on terms satisfactory to Japan and, more generally, the aggressiveness that has characterized the recent foreign policy of the Soviet Union as symbolized by its invasion of Afghanistan. A major improvement in bilateral relations almost certainly could not be achieved without major changes in the Soviet approach to both problems. This is not likely to occur. ■

An adverse Japanese reaction probably is one of the potential costs the Soviets find least painful to contemplate when making decisions affecting basic defense or foreign policy. Therefore, it is more fruitful to focus on the possibility that Moscow might alter its policy on the Northern Territories, the less important of the two problems. ■

The Soviets may question whether they would really gain very much if they returned the disputed islands. The Japanese might sign a peace treaty but refuse to adopt a more cooperative attitude toward the Soviet Union. As an object of Japanese friendship and cooperation, the Soviet Union in any case would still rank well below China, to say nothing of the United States. Soviet fear that returning the islands would stimulate East European and Chinese appetites for

adjustments in their borders with the USSR is probably the most important constraint inhibiting the USSR from making a move in this direction. The Soviets also want to avoid losing the rich fishing grounds and the opening of the Sea of Okhotsk to foreign military penetration [REDACTED]

Nevertheless, a shift in Moscow's position on the Northern Territories is possible, if only because current policy entails such heavy costs for the Soviet Union in Japan. Some Japanese hope that the new Soviet leadership that will be in place by the mid-1980s might undertake such a shift. The likelihood of a Soviet initiative would increase if Moscow perceived an opportunity to make gains in other arenas. For example, if Sino-Japanese relations deteriorated, Moscow might calculate that an all-out peace offensive toward Japan—one involving real concessions on the territorial issue and perhaps more advantageous trade terms for the Japanese, as well as acquiescence in current Japanese security policy—might be successful. The Soviets might hope not only to clear the way for the signing of a peace treaty and a significant improvement in bilateral relations, but also to woo Japan away from China and toward the USSR. [REDACTED]

If Moscow decided to release all four of the disputed islands, Tokyo would immediately agree to sign a peace treaty. Tokyo might even agree to a settlement involving only two of the islands, although the political benefits for the Soviets of a less generous package would not be as great. Coupled with a sustained effort to take a more accommodating approach on other issues, an acceptance of the political realities in Japan, and greater sensitivity to Japanese points of view, either form of an islands-for-treaty exchange could lead to a substantial improvement in Soviet-Japanese relations. Depending on developments on other fronts, it might fulfill Moscow's hopes of drawing Japan closer to the Soviet Union and away from China. [REDACTED]

If either of the two principal alternatives materialized (strained Sino-Japanese relations or improved Soviet-Japanese ties), the possibility that a US-China-Japan entente might emerge would recede and Japan would return to a position more nearly equidistant between the two Communist powers. This would tend to assuage some Soviet concerns and thus reduce the stimulus for disruptive Soviet behavior. [REDACTED]

If Sino-Japanese relations deteriorated but Soviet-Japanese relations remained cool, Tokyo would have even greater incentives to build up the SDF and engage in more serious defense cooperation with the United States. [REDACTED]

If Soviet-Japanese relations improved while Sino-Japanese relations remained friendly, the impetus for a more positive approach to defense issues presumably would be reduced. Tokyo might then permit allocations to defense to increase at a slower rate and display less interest in giving substance to US-Japanese defense cooperation. [REDACTED]

Appendix A

Japan's Trade With China and the USSR, 1970-79

Table A-1

Japan's Trade With China and the USSR

	Exports				Imports			
	Million US \$		Percent of Total Exports		Million US \$		Percent of Total Imports	
	China	USSR	China	USSR	China	USSR	China	USSR
1970	569	341	2.9	1.8	254	481	1.3	2.5
1971	578	378	2.4	1.6	321	496	1.6	2.5
1972	609	504	2.1	1.8	491	594	2.1	2.5
1973	1,041	485	2.8	1.3	971	1,076	2.5	2.8
1974	1,989	1,102	3.6	2.0	1,307	1,419	2.1	2.3
1975	2,256	1,624	4.0	2.9	1,532	1,168	2.6	2.0
1976	1,663	2,232	2.3	3.4	1,371	1,168	2.1	1.8
1977	1,939	1,914	2.4	2.4	1,547	1,416	2.2	2.0
1978	2,049	2,502	3.1	2.6	2,030	1,409	2.6	1.8
1979	1,699	2,461	3.6	2.8	2,955	1,869	2.7	1.7

Table A-2

Japan's Imports of Fuels From China and the USSR

	Coal				Petroleum *			
	Million US \$		Percent of Total Coal Imports		Million US \$		Percent of Total Petroleum Imports	
	China	USSR	China	USSR	China	USSR	China	USSR
USSR								
1970	4	44	.39	4.3	2	33	.07	1.2
1971	8	46	.79	4.5	2	32	.06	.88
1972	5	49	.46	4.5	2	26	.04	.58
1973	7	57	.51	4.2	35	56	.51	.83
1974	13	111	.44	3.8	419	103	1.9	.48
1975	17	164	.48	4.7	747	64	3.6	.30
1976	12	176	.33	4.9	579	89	2.5	.38
1977	20	166	.56	4.6	665	76	2.6	.29
1978	37	133	1.1	4.3	781	73	3.0	.28
1979	69	124	1.9	3.3	1,119	161	2.9	.42

* Includes crude petroleum and petroleum products.

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Table A-3

Japanese Imports of Wood From the USSR

	Million US \$	Percent of Total Wood Imports
1970	198	12.5
1971	197	13.4
1972	226	12.9
1973	422	12.3
1974	520	14.1
1975	417	15.8
1976	416	11.7
1977	538	14.1
1978	528	12.7
1979	732	9.9

Table A-4

Japanese Exports of Machinery to China and the USSR

	Million US \$		Percent of Total Machinery Exports	
	China	USSR	China	USSR
1970	79	87	2.3	2.6
1971	79	92	1.9	2.2
1972	52	164	1.0	3.1
1973	101	152	1.4	2.1
1974	300	186	3.1	1.9
1975	423	415	3.9	3.8
1976	306	551	2.2	3.9
1977	100	654	0.6	3.7
1978	347	1,043	1.4	4.3
1979	590	674	2.3	2.6

Table A-5

Japanese Exports of Steel to China and the USSR

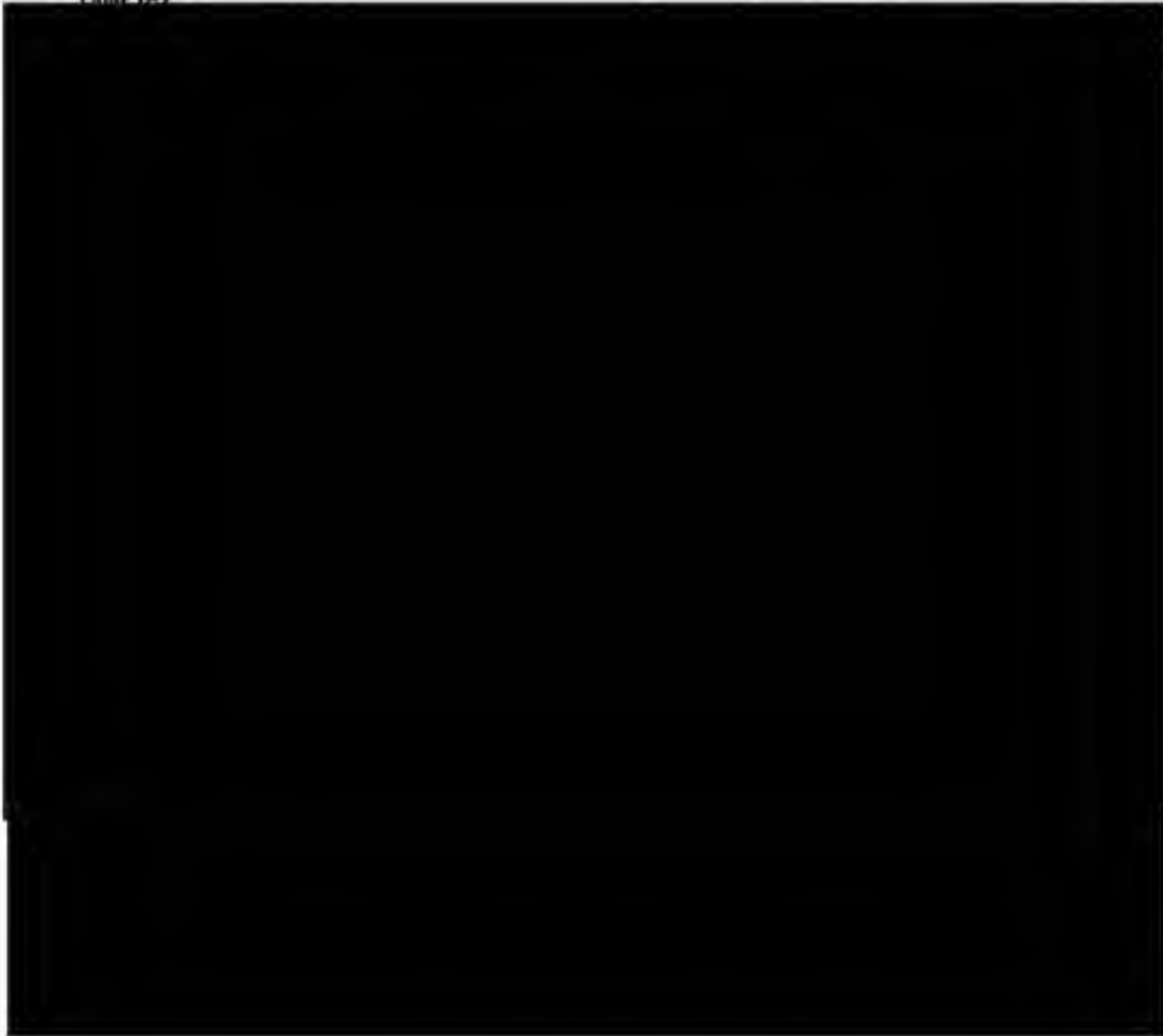
	Million US \$		Percent of Total Steel Exports	
	China	USSR	China	USSR
1970	237	45	8.4	1.6
1971	254	65	7.3	1.9
1972	232	87	6.5	2.4
1973	506	131	9.6	2.6
1974	726	484	6.8	4.5
1975	796	548	8.0	5.5
1976	823	1,062	7.9	10.3
1977	986	550	9.5	5.3
1978	1,567	726	13.3	6.2
1979	1,611	1,028	11.5	7.3

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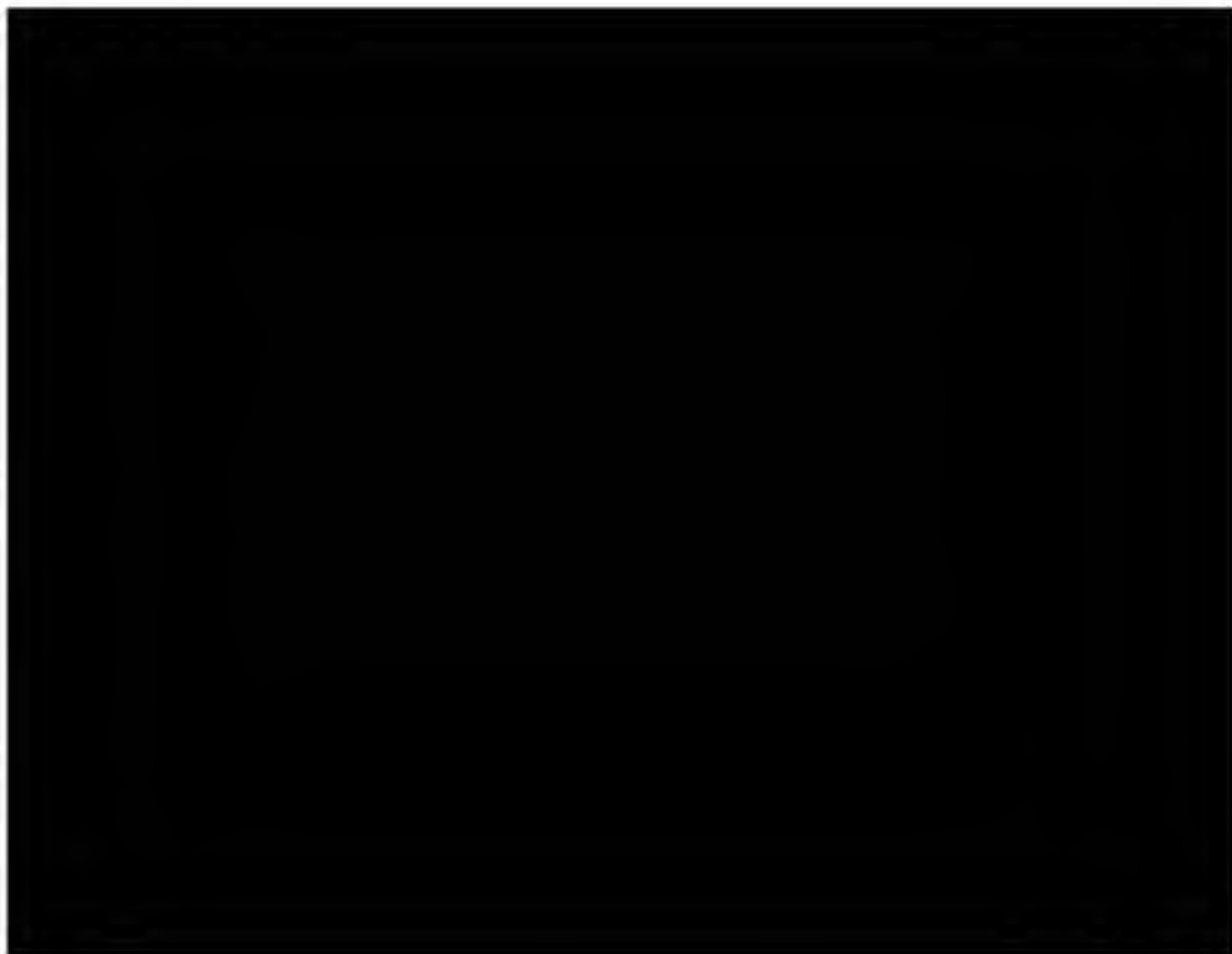
Appendix B

Japanese-Supported Resource Development Projects in China and the USSR, 1970-79

Table B-1

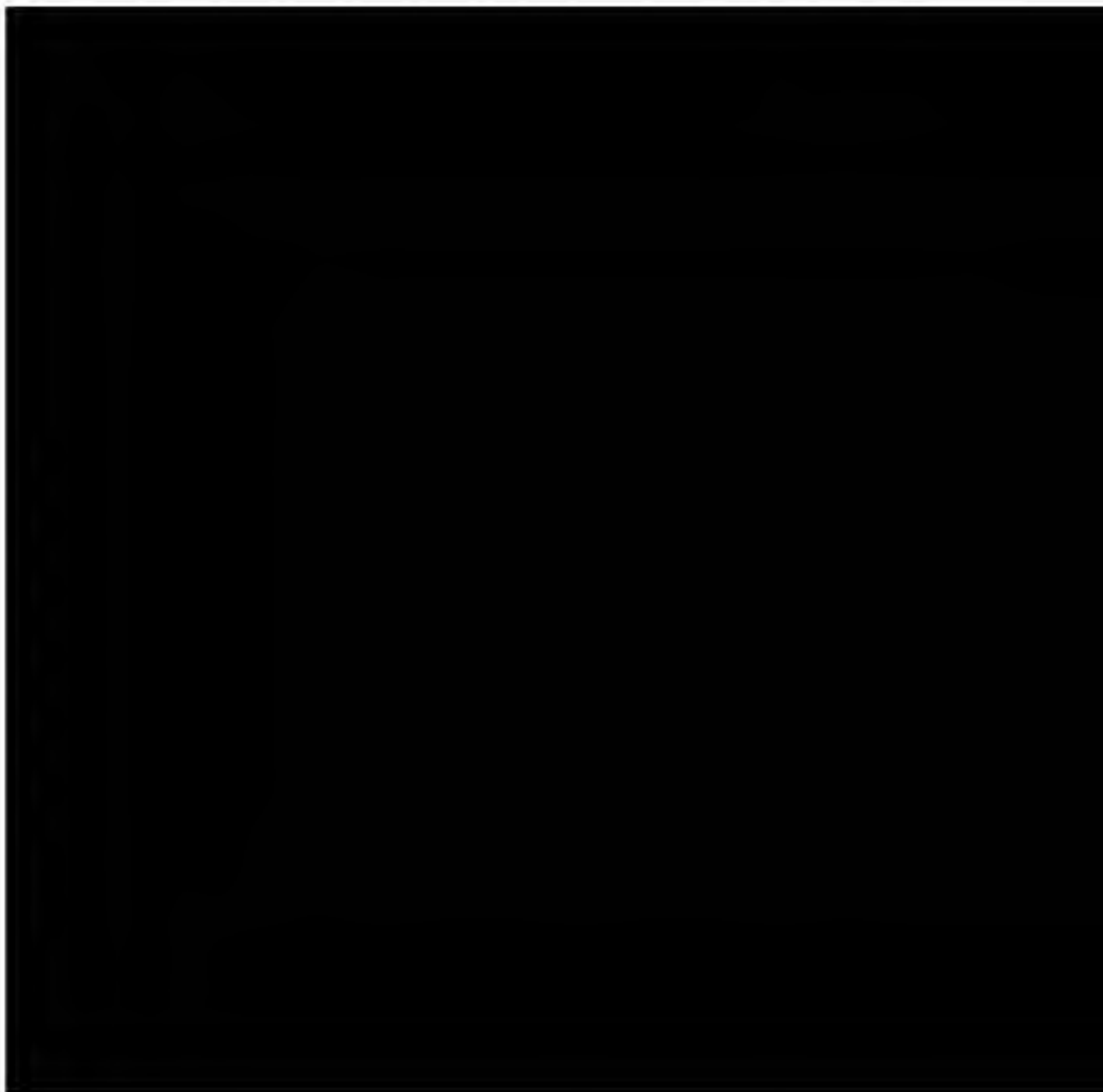


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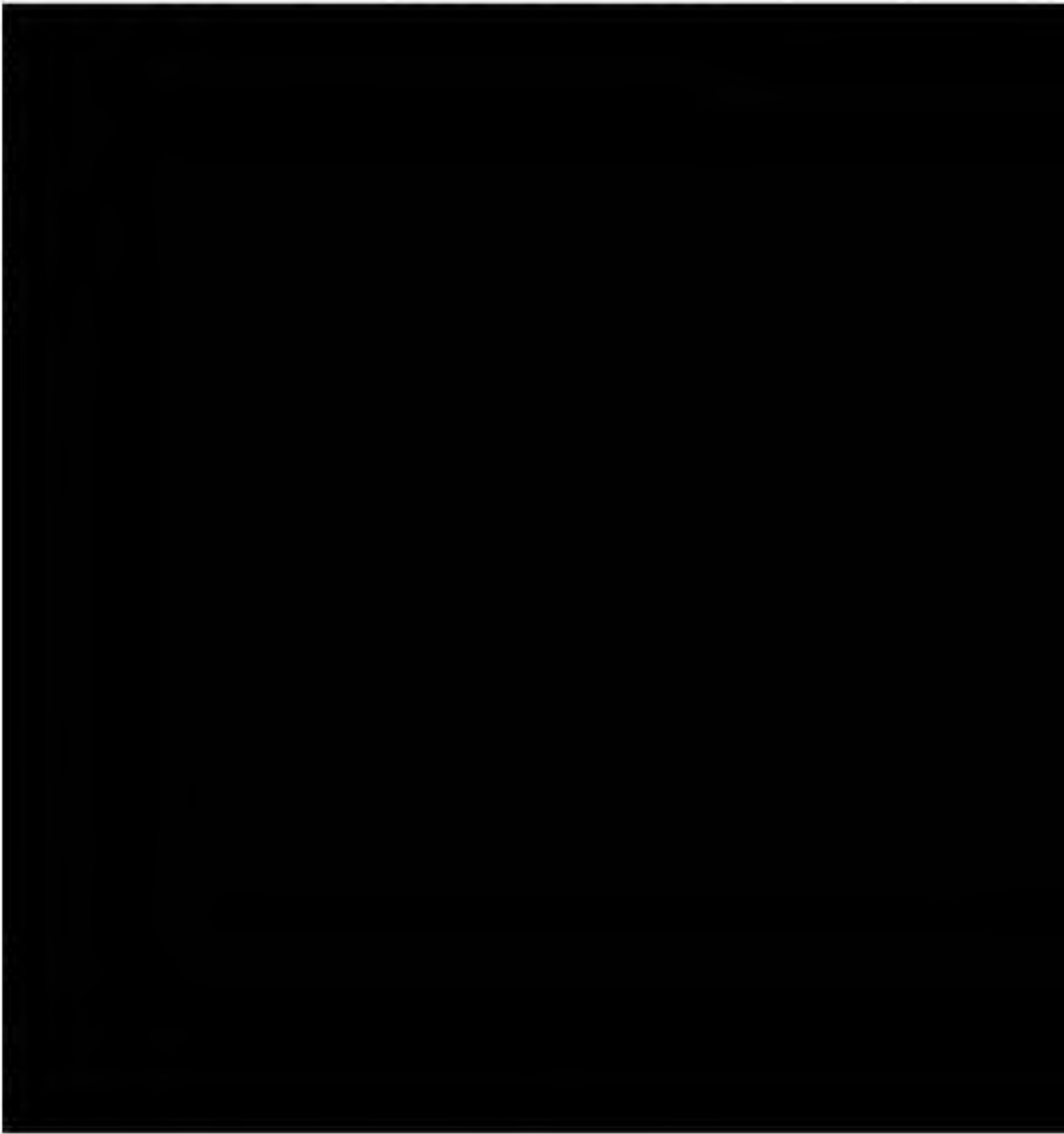
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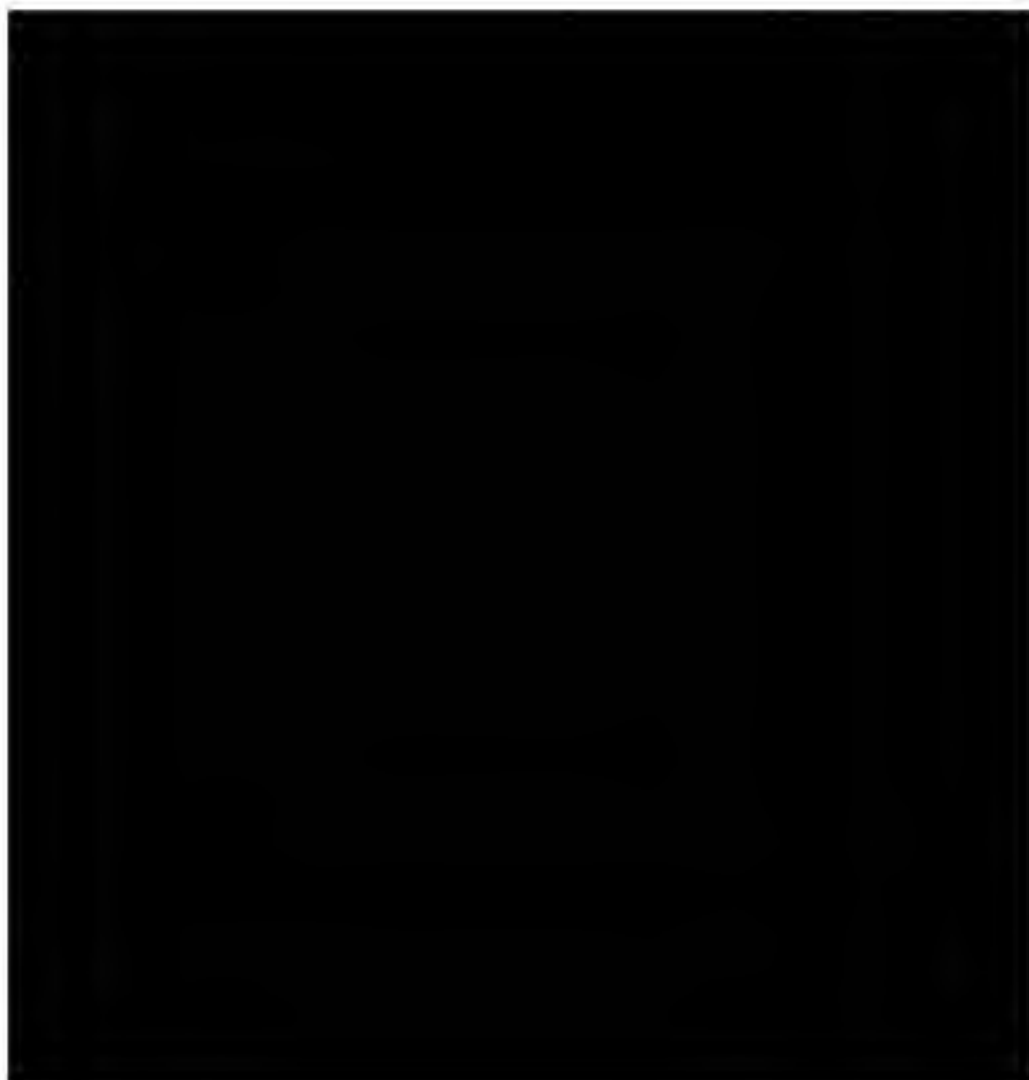
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Japan: Diminishing Interest in Soviet Trade Resources

An Intelligence Assessment

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Japan: Diminishing Interest in Soviet Trade Resources



An Intelligence Assessment

*Information available as of 29 May 1981
has been used in the preparation of this report.*



~~Secret~~
~~PA 81-10221~~
~~ER 81-10222~~
~~June 1981~~

**Japan:
Diminishing Interest
in Soviet Trade Resources** [REDACTED]

Key Judgments

Trade with the Soviet Union remains relatively unimportant to the Japanese economy in spite of a rapid expansion in economic relations during the past 10 years. The complementary nature resource-rich Siberia and highly industrialized Japan provides a strong incentive for greater interdependence, and the potential for further trade is vast. In addition, the Japanese steel, shipbuilding, and machinery industries view the USSR as an important alternative market because of slower economic growth and rising protectionism in the West. [REDACTED]

Until recently, Tokyo and Moscow apparently believed that they might be able to turn expanded economic relations to political advantage. The Japanese hoped that increased economic relations would enhance the Soviet stake in harmonious relations between the two nations. For its part, Moscow assumed that Japanese businessmen would find the lure of Soviet markets and natural resources irresistible and eventually pressure Tokyo to improve political relations. [REDACTED]

In fact, the pace of Japanese involvement in Siberian development has slowed sharply since the late 1970s because of Soviet heavyhandedness and political-economic change in Japan. Moscow flaunted its military superiority in a way particularly irksome to the Japanese. Tokyo's tilt toward China has caused Moscow to view Japan as the potential third partner, with China and the United States, in a hostile Pacific triad. The Japanese have delayed resource development projects because they are reluctant to become dependent on Soviet sources of supply, are concerned about the security implications of several projects, are distrustful of Soviet intentions in Asia, and have less need for Soviet raw materials than they once did. [REDACTED]

The cooling of Soviet-Japanese relations may mean that the opportunity available in the early 1970s for rapid exploitation of Siberian resources by Japanese companies has been dissipated. Some projects continue to be implemented at a slower pace, but Tokyo's linking of political and economic relations makes full-scale development less probable. The Soviet treatment of Japan is unlikely to soften Tokyo's attitude. Even if the post-Afghanistan sanctions on the USSR were abolished, a number of political and economic factors would restrain the expansion of trade and economic cooperation in the 1980s. [REDACTED]

Japan: Diminishing Interest in Soviet Trade Resources

The Trade Perspective

Trade with the Soviets is relatively unimportant to the Japanese economy. In 1980 the Soviet Union accounted for only 1.7 percent of the value of Japan's total foreign trade, and the Soviet share in any given year has never exceeded 3 percent of the total. With the exception of platinum-group metals, Japan's dependence on the USSR for supplies of individual imported commodities remains low. On the export side there is little danger of major Japanese industries becoming overreliant on the Soviet market. The Japanese enjoy substantial annual trade surpluses, such as \$1.2 billion in 1980.

Exports

Moscow has relied heavily on Japan for steel and industrial machinery. Producer goods make up the majority of Japanese shipments; iron and steel alone constitute one-third of all exports and two-fifths of sales of manufactured goods. Oil well drilling pipe, well casing and tubing, large-diameter welded pipe for pipelines, seamless pipes and tubes, and special steels lead the list. Steel plate, which the Soviets use to manufacture large-diameter pipe, is also important. If the West Europeans decide to move ahead with the Yamburg gas pipeline and Tokyo approves Export-Import Bank financing of Soviet purchases for the project, the volume of steel exports will be even higher in the future. During preliminary negotiations with Japanese steelmakers, Moscow proposed shipments of 500,000 tons of large-diameter pipe in fiscal year 1981 (which began last April) and 1 million tons in each of the subsequent three years. Since agreement on Yamburg is unlikely in the immediate future, the Soviets have instead reached preliminary agreement with the Japanese to purchase 750,000 tons of pipe in FY1981 for use in the construction of a pipeline from Urengoi to Pomali. This figure represents an increase of 50,000 tons over the level of 1978, the previous peak in pipe exports to the USSR.

Even in the steel sector, exports to the Soviet Union constitute only a small part of Japanese foreign sales. In 1980, shipments to the Soviet Union, the industry's

third largest overseas customer, amounted to only 6 percent of total iron and steel exports. Moreover, drilling pipe and casing now booked for shipment to the Soviet Union could easily be diverted to other markets because of a worldwide oil drilling boom. The complete cessation of business with the Soviet Union would seriously affect Japanese steelmakers in only one product line—large-diameter welded pipe. The Soviet Union has been the principal buyer of this item for many years, thus the importance to the Japanese of such pipeline projects as Yamburg.

Japan's machinery exports to the Soviet Union are almost all capital goods destined for resource development projects or for upgrading Soviet manufacturing facilities. The value of shipments varies widely from year to year, as projects are started and finished. In 1978, machinery worth almost \$1 billion accounted for about 40 percent of all exports to the Soviet Union. The next year the total fell to about \$600 million. The industry generally attributes a further decline to \$550 million in 1980 to Tokyo's ban on Export-Import Bank credits to the Soviet Union after the invasion of Afghanistan. Japan's machinery manufacturers customarily rely on official credits to finance large-scale plant exports.

Machinery exports should expand in 1981. Tokyo has already approved in principle a \$1 billion buyer's credit in connection with the third phase of a joint timber resources project. The contract signed by the Soviets last March specifies that plant and equipment purchases must be made within two years. Japanese firms are also bidding for contracts to build a number of chemical plants included in the Soviet Union's new five-year plan. The availability of government-backed credits is crucial, and machinery manufacturers and trading companies can be expected to lobby the government for removal of the economic sanctions now that Washington has lifted the grain embargo. Moscow may be trying to increase the pressure by offering a Hitachi-Marubeni group the prospect of a \$1 billion order for Yamburg pipeline gas compressor stations.

Machine tools essential to the improvement of industrial productivity are the most important component of machinery exports to the USSR. Metalworking machine-tool exports increased by 45 percent in 1980. Many Soviet purchases are for state-of-the-art horizontal boring and drilling machines, numerically controlled machining centers, and lathes. The Soviets also rely on Japanese suppliers for numerical controls and industrial robotics technology. The Soviet market is no more important for machine tool makers than it is for steelmakers. Shipments bound for the Soviet Union were only 4 percent of Japanese exports of machine tools in 1980. Unlike pipe fabricators, Japanese machine-tool manufacturers are not highly dependent on the Soviet market for the sale of any one product line. ■

Imports

The inability of the Soviet Union and Japan to come to terms on many of the resource development projects discussed over the years has kept the volume of Soviet exports below its potential. Many of the resource projects involve substantial sums and exceedingly long leadtimes, and the Japanese have gone elsewhere to secure needed raw materials. Last year the share of Japanese imports coming from the USSR dropped from the 1.7 percent of 1979 to 1.3 percent. Although Japanese imports were inflated by an increase of about 75 percent in the price of crude oil, the value of imports from the Soviet Union declined in real terms. Prospects are not good for any resurgence soon. ■

Wood pulp, logs, and lumber composed two-fifths of all imports from the Soviet Union. Japanese trading houses have reacted to a two-year downturn in the domestic housing market by negotiating a 15- to 20-percent cut in log prices for the second quarter. Volume, which is decided on an annual basis, remains unchanged. The prospects for a rapid revival of the housing industry, and thus lumber import prices, are not good. ■

Of the \$500 million Japan spent on Soviet manufactures and semimanufactures in 1980, 45 percent consisted of platinum-group metals—platinum, palladium, and rhodium—critical to Japan's advanced technology sectors. Japanese dependence on the Soviet Union for strategic metal supplies is substantial. By value, the Soviet Union provides 39 percent of Japa-

nese platinum imports, 62 percent of its palladium imports, and 38 percent of its rhodium imports. Dependence on the Soviet Union for other metals is low; Japan imported aluminum worth almost \$100 million from the Soviet Union in 1980, but this was only 7 percent of total aluminum imports. ■

Japan is not dependent on the Soviet Union for mineral fuels. Imports from the USSR as a percentage of all mineral fuel imports have fallen steadily to 0.4 percent in 1980. Fuel oil worth approximately \$130 million was the most valuable item. Coal imports have declined consistently over the last five years to a 1980 total of 2.2 million tons worth \$124 million; in both FY1979 and FY1980, Soviet coal shipments have fallen short of the contracted quantities. The Japanese steel industry is concerned that imports of coking coal, which constitute most of the Soviet coal sold to Japan, will be slashed to 1 million tons in FY1981. Coal that otherwise would have been exported to Japan is now being consumed within the Soviet Union because of declining imports from Poland. Transportation bottlenecks in the Soviet Far East also may be contributing to the slowdown in shipments. Although the short-term outlook for energy imports from the Soviet Union is poor, ongoing joint development of the Yakutsk coal deposits and Sakhalin oil and gas should lead to some increase in the longer run. ■

Government-to-Government Trade Relations

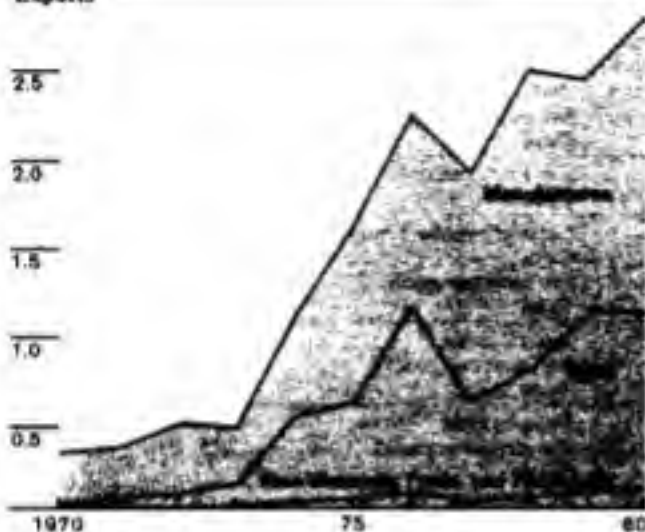
Recently, the renewal and revision of government-to-government agreements between Japan and the USSR has given the Soviet leadership an opportunity to rekindle the interest of Japanese businessmen in bilateral commerce and thereby increase the pressure on Tokyo to ease the post-Afghanistan sanctions. Tokyo has already initialed a new bilateral trade and payments agreement covering 1981-85 so that the expiration of the old pact would not create obstacles for businessmen in their efforts to capitalize on opportunities presented by the Soviet Union's 11th Five-Year Plan. Similar to the preceding accord, the new pact provides for:

- The import from the Soviet Union of approximately 90 items, such as wood, mineral fuels, cotton, and ores of several kinds.
- The export to the Soviet Union of roughly 70 items, including iron and steel products, industrial plants, machinery, and chemicals.

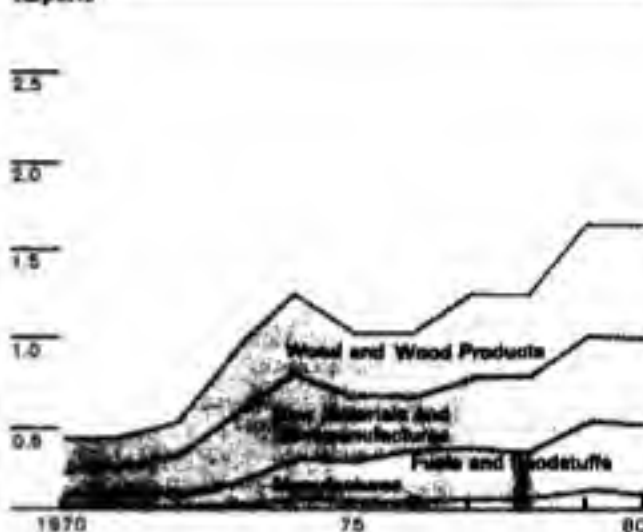
Japan: Trade With the USSR

Billion US \$

Exports



Imports



- The use of convertible currencies in bilateral transactions.
- Regular consultations between officials of the two governments.
- Procedures for the settlement of commercial disputes.

Although the new agreement was widely heralded in the Japanese press as the beginning of a relaxation of the sanctions and an improvement in economic relations with the Soviets, the accord itself did not negate Tokyo's sanctions. Japan continued to:

- Restrict trade credit to the Soviet Union.
- Prohibit the export of high technology items included in the COCOM list.
- Restrict high-level intergovernmental personnel contacts.

For the present, Tokyo seems to be doing no more than is necessary to keep intact the pre-Afghanistan framework for bilateral trade. Nothing has been done to

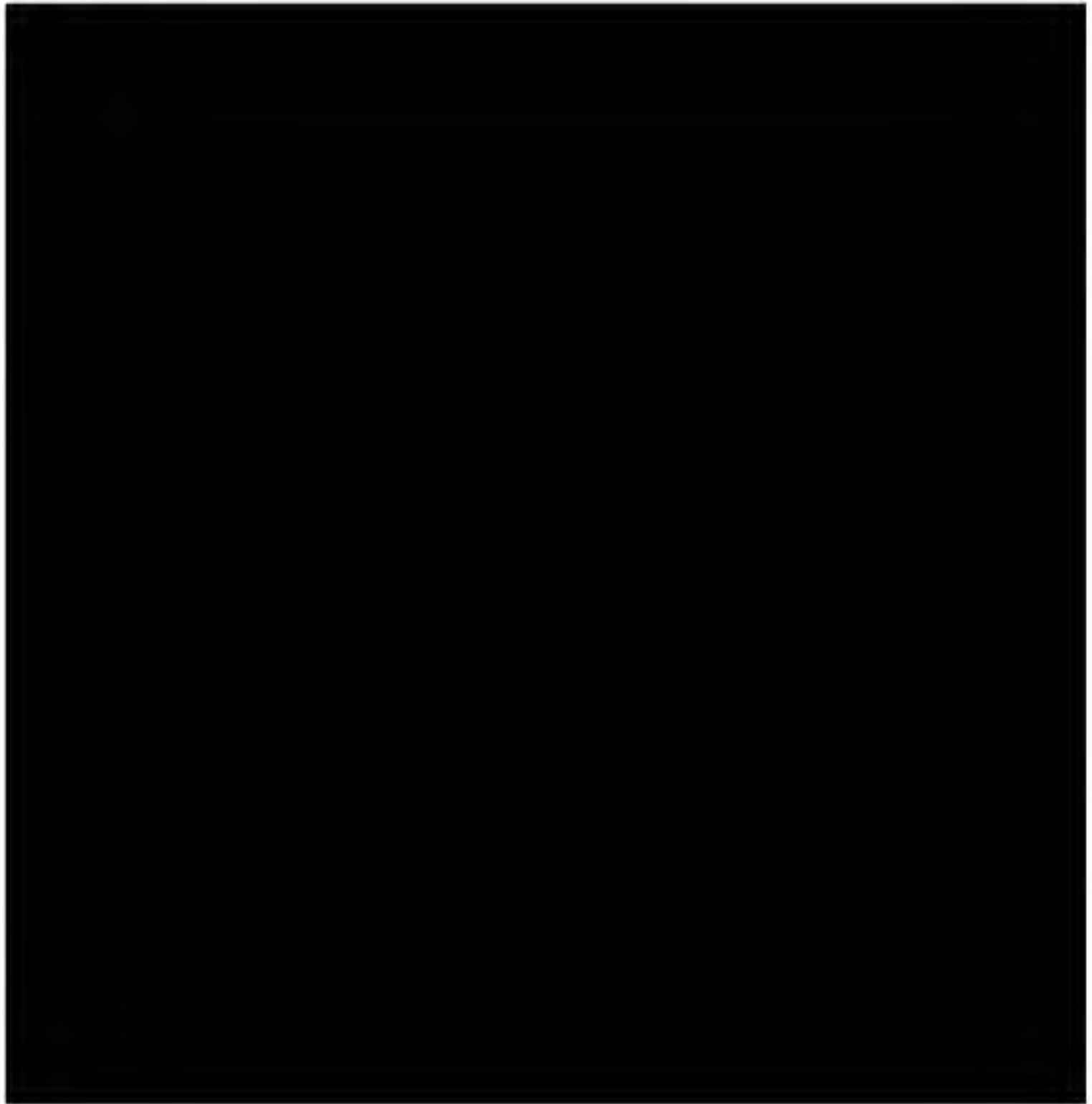
embellish the framework by, for example, negotiating a tax treaty.

On the other hand, Moscow, appears eager to reach agreement on some issues to establish the pretense of normal relations. The Soviets were especially accommodating during recent negotiations with the Japanese to settle airline routes and fishing quotas. Beyond undermining the existing set of economic sanctions, the Kremlin may also be trying to engender Japanese resistance to the sanctions that have been proposed if the Soviets invade Poland.

Export Credits

In complying with the sanctions, the Export-Import Bank has suspended almost all new credits, including suppliers' credits for regular merchandise trade. Japanese businessmen, who are agitated by news of West European competitors signing plant-export contracts with the Soviets and want to supply materials for the proposed Yamburg pipeline project, have been clamoring for a relaxation of the curbs.

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In September 1980, the Japanese Government assuaged the complaints of the private sector without destroying the basic sanctions framework by granting additional credits for two ongoing resource development ventures. Approval was given for the extension of buyers' credits to the Soviet Union to support a \$40 million supplement to the South Yakutsk coking coal project and the third phase of the Siberian timber project. Tokyo has also been contemplating approval in principle for suppliers' credits of less than \$100 million. This limit was chosen because of a US proposal to review projects of \$100 million or more in COCOM. At present, official supplier credits have been authorized for only two small projects—a \$5.6 million high-pressure kiln for lacquer manufacturing and a \$7.3 million sulfur-concentration project. Final agreement was delayed until December when the Soviets agreed to an interest rate consistent with OECD guidelines on export credits. ■

Officials contend the South Yakutsk and forestry projects are continuations of existing projects and therefore special cases. They contend that the additional credit for the South Yakutsk mining project is necessary to ensure commencement of coal deliveries to Japan in 1983. Without the infusion of new money, the USSR might be able to renege on its obligation to repay earlier loans with coal from the project. The Japanese argue that they, rather than the Soviets, would be the losers in that case. The Japanese have been eager to move forward with the forestry project because a substantial percentage of total lumber imports comes from the Soviet Union. ■

Tokyo justifies the approval of suppliers' credit of less than \$100 million with the argument that it cannot sit idly by while the West European countries continue to trade with the Soviets on a business-as-usual basis. Japanese businessmen and diplomats have cited Creusot-Loire's takeover of the Novolipetsk steel plant project and the signing of a contract to build the Sayansk aluminum project by Klockner of West Germany as examples of opportunities lost because West European governments have been less stringent in their application of sanctions. The Japanese have a strong case; the Europeans have approved official credits or credit guarantees and adopted a liberal view of COCOM restrictions that otherwise might have blocked the projects. ■

One determinant of Tokyo's future decisions on export credits will be its perception of trends in West European trade with the Soviets. The Japanese tend to interpret every trip to a major West European country by high Soviet trade officials as the culmination of important trade negotiations. The outcome of talks on the Yamburg project could have a decisive influence on Japanese policy. If the West Germans reach an agreement, Japanese big business will intensify its lobbying for an easing of Tokyo's credit restraints. ■

A second influence on Japanese export credit policy is the stance of the United States. Abolition of the grain embargo opens the door to renewed private-sector lobbying for removal of Japanese sanctions against the Soviets. Moscow is encouraging Japanese businessmen by initiating or reviving commercial negotiations for a variety of plant export proposals. Some officials within the Ministry of International Trade and Industry (MITI) singled out the announcement of US approval for export license applications related to the Sakhalin oil and gas project soon after the lifting of the grain embargo as an indication that the United States is further relaxing its sanctions. ■

Tokyo's first move will probably be a relaxation of the curb on high-level personnel exchanges, followed by the granting of a few carefully selected export credits on a case-by-case basis. The Japanese Government is likely to take a firmer line on restrictions on the sale of COCOM items. ■

Resource Development Projects

Resource development projects in the USSR no longer appear as advantageous to the Japanese as they did from 1968 through 1977. Japan has been reluctant to move further ahead in Siberia for both economic and political reasons. Siberia's severe climate, great distances, and perennial labor shortages are serious obstacles to profitable development. Moreover, the Soviets have proved to be difficult business partners. They have sometimes overplayed their hand, apparently convinced that the Japanese were so hungry for Siberian resources that they would ultimately accept Soviet terms. Japanese entrepreneurs, however, are used to operating in a global economic arena and evaluate Siberian resource development projects as one of several alternatives. During the late 1970s, Japanese

businessmen began to conclude that it would be more prudent and profitable to pursue diversification elsewhere. Nevertheless, they have kept the door open by continuing to discuss new projects with the USSR. [REDACTED]

The judgments of Japanese businessmen on a project's economic viability are shaped in part by perceptions of the salability of its output at home. In the late 1960s and early 1970s high Japanese growth rates and steadily expanding demand for raw materials eliminated any doubts about the availability of markets five or 10 years in the future. Since the oil crisis of 1973/74, however, demand for the commodities imported from the Soviet Union has become much more erratic. A shift in the Japanese economy from raw-material-intensive heavy industries to technology-intensive industries is diminishing the need for new sources of

many raw materials. Lower growth rates and sectoral shifts have narrowed the number of fields in which Japanese investors can feel certain of an adequate return on investment. Oil, gas, coal, and pulpwood projects still hold promise, but proposals for the development of nonferrous metals, iron ore, and asbestos lack appeal. [REDACTED]

A number of other concerns contribute to pessimism even in the case of the most promising commodities:

- Shortfalls and delays in the deliveries of some commodities have raised questions about the reliability of the Soviet Union as a supplier; the USSR's inability to fulfill coal export contracts is the most recent example.



The economic limitations of the Soviet Union stand in the way of several proposals. An acute shortage of labor in the Far East may contribute to Soviet reluctance to move ahead with pulp and paper plants, from which the Japanese hope to obtain long-term supplies. Lack of capital is another concern. As bilateral relations have worsened, Soviet inconsistency, secretiveness, and bargaining tactics have delayed, and in some cases even prevented, Japanese acceptance of project proposals. [REDACTED]

Given the long-term nature of these economic constraints, the immediate prospects for joint resource development are mixed. In spite of difficulties in early 1981, timber projects should progress. Most of the USSR's timber exports are logs, which require relatively little labor to cut. Moscow's willingness to export logs makes it an attractive supplier to Japanese processors who are faced with increased opposition to log exports in Canada, the United States, and Indonesia. The prospects for pulpwood and coal exports are poorer because the Soviets are unlikely to give them sufficient priority. The Japanese should eventually receive gas from Sakhalin, but probably later than scheduled in the original plan. Other projects are likely to remain in limbo for some time. [REDACTED]

The Political Perspective

The economic sanctions imposed by Tokyo after the Soviet invasion of Afghanistan made the connection between economics and politics more explicit than at any time since the restoration of diplomatic relations in 1956. The sanctions are only one manifestation of broader alterations in Japan's foreign policy. The recent buildup of Soviet strength in the Far East and the diversion of some US forces to the Indian Ocean have put more pressure on Japan to accept greater military and political responsibilities in northeast Asia. These increased responsibilities reduce Tokyo's freedom to circumvent the political and military ramifications of economic cooperation with the Soviet Union. [REDACTED]

The Kremlin's reaction to the signing of the Sino-Japanese Peace and Friendship Treaty and the movement of a Soviet garrison into the Northern Territories have put additional strain on Tokyo. The Japanese suspect the Soviet troop buildup in the Northern Territories was an attempt to deter them from improving relations with Beijing. If so, the attempt has backfired.


The potential Soviet threat to Japan's security has assumed an immediacy it never had before. The presence of troops on the disputed territory has also underlined the USSR's contention that the islands are an integral part of the Soviet Union. No longer willing to ignore Moscow's refusal to even acknowledge the existence of a territorial dispute, Tokyo has linked basic improvements in relations to a Soviet admission that a territorial problem exists, as well as to Soviet withdrawal from Afghanistan. [REDACTED]

Although many Japanese now accept a greater degree of linkage between their economic and political relations with the Soviet Union, they are still unprepared to subordinate Soviet-Japanese trade and economic interests to political issues arising elsewhere in the world. In the case of overt Soviet military intervention in countries outside the Soviet Bloc, Tokyo will respond as it did after Afghanistan. [REDACTED]

Poland is a special case. Because it is a satellite country, Soviet intervention there might not arouse Japanese politicians were it not for the likely reactions of Japan's allies. Afghanistan and the relative decline in US power during recent years have heightened Tokyo's awareness of the need for Western unity in the face of aggression. [REDACTED]

Moscow could soften Tokyo's policies by withdrawing troops from Afghanistan, offering political concessions on the Northern Territories, or presenting attractive new trade opportunities. The Kremlin, however, has shown no indication that it feels compelled to break the present stalemate in relations with Japan. Recent Soviet diplomatic initiatives fail to address the crucial

territorial issue and therefore have no chance of success. A Japanese foreign policy more independent of Washington and the reversal of Tokyo's rapprochement with Beijing are major policy goals of the Kremlin, but no coherent strategy exists to achieve them.





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Japan: Evolving Policy Toward the Third World



An Intelligence Assessment



~~Confidential
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Japan: Evolving Policy Toward the Third World

Since the late 1970s Japan's policy toward the LDCs has evolved as Tokyo's own view of Japanese national interests has changed and as Japan has responded to US pressure to play a global role commensurate with its economic power.

Traditional LDC Partners

Economics have always dominated Japanese ties to developing nations. To Japan, the LDCs are sources of raw materials, fuels, and foodstuffs indispensable to its survival and industrial growth and important markets for Japanese manufactured exports. Japanese officials argue that the long-term stability of the Japanese economy requires stable trading relations with the LDCs.

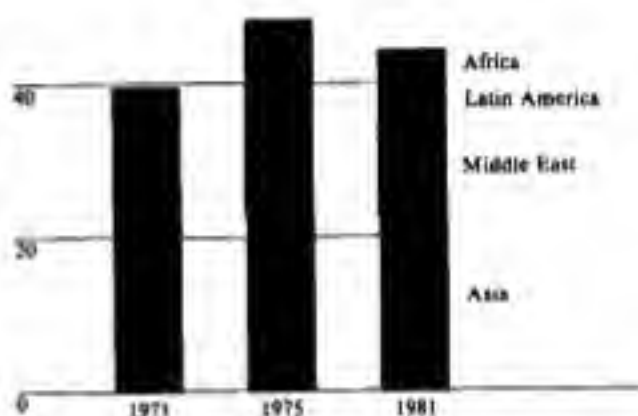
Aggregate trade and investment numbers tell the story. Japan's dependence on LDC markets and sources of supply has been increasing. In 1981 LDCs absorbed 44 percent of total Japanese overseas sales, up from 39 percent in 1971 (see figure 1). LDCs also supplied nearly 60 percent of Japanese imports in 1981 compared with 42 percent a decade earlier, in part because of higher oil prices. Moreover, Japan is more dependent on the LDCs than is the United States or Western Europe. The United States marketed only 37 percent of its exports in the LDCs in 1981 and drew only 44 percent of its imports from those countries. For Western Europe, the shares were even smaller.

In terms of major commodities, LDCs supplied 25 to 35 percent of Japanese food imports and 40 to 45 percent of raw materials over the past decade. LDCs have been particularly important as sources of supply for fuels; they meet almost 90 percent of Japan's requirements, including almost all oil and liquefied natural gas (LNG).

Asia stands out among LDC regions, both as a supplier of a broad range of commodities and as a

Figure 1
Japan: LDC Share of Total Exports,
by Region

Percent
60

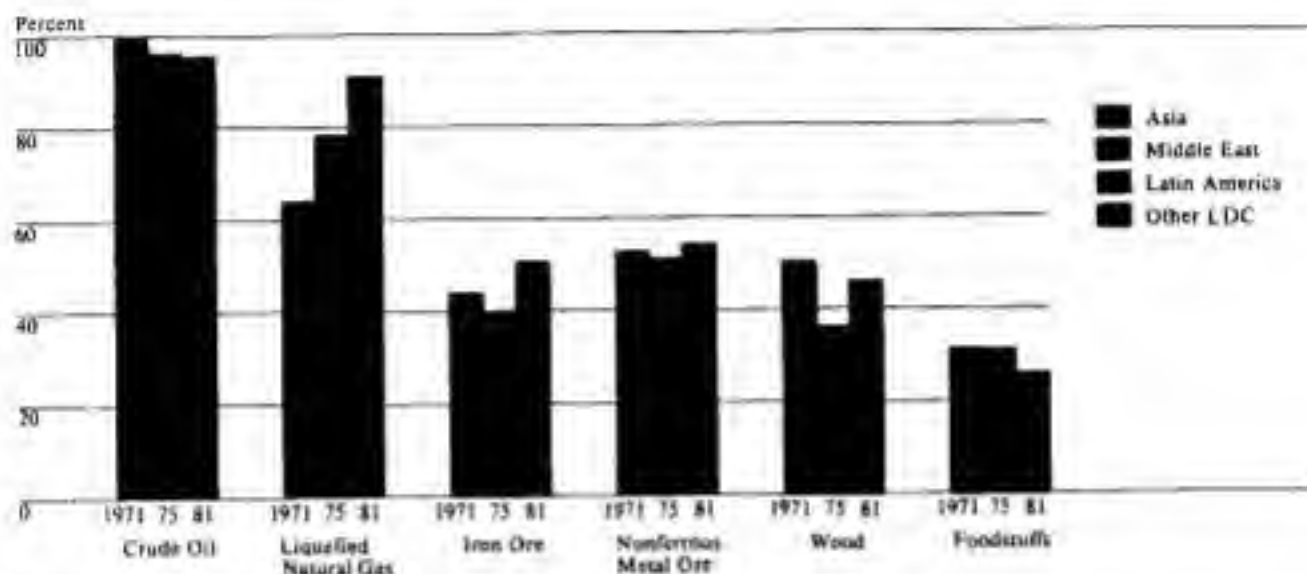


market for the manufactured capital and consumer goods that dominate Japanese overseas sales. Asia ranks first as a source of supply for foodstuffs, wood, nonferrous metal ores, and LNG; second for crude petroleum and iron ore (see figure 2). It also absorbs about half of all Japanese exports to the LDCs. The Middle East continues to supply most of Japan's oil needs and much of its LNG. It also is Japan's second-most-important LDC regional market.

Reflecting Tokyo's drive to line up secure sources of fuel and raw materials, LDCs had received \$19.7 billion in direct investment by 1981, more than half of

¹ Official Japanese trade, investment, and aid data were used in this report.

Figure 2
Japan: LDC Suppliers of Crucial Commodities, by Region



Japan's overseas investment worldwide. Major resource development projects were undertaken in Indonesia (oil and gas), Brazil (iron ore), and the Kuwait neutral zone (oil).

Nonetheless, the aggregate statistics mask the extent to which Japan's economic interests have been concentrated on a fairly small number of LDCs:

- The fast-growing East Asian LDCs.
 - The raw material suppliers in ASEAN.²
 - Oil producers in the Middle East.
 - A few countries in Africa and Latin America with high-growth potential or large raw material bases.
- Five LDCs—Indonesia, Brazil, South Korea, Hong Kong, and Saudi Arabia—account for 53 percent of Japanese investment in developing countries.

New Political Considerations

In the late 1970s Tokyo began to take another look at its relationship with the LDCs. The immediate causes

of this reevaluation were Vietnam's invasion of Kampuchea in 1978 and the Soviet invasion of Afghanistan in 1979. To the Japanese, these Soviet or Soviet-backed advances directly threatened the security and stability of the Middle East and Southeast Asia, the LDC regions of greatest importance to Japan.

Tokyo's new perspective also reflects a more basic change in Japan's overall foreign policy. Through most of the 1960s and 1970s, Tokyo had stressed Japan's determination to be on good terms with all countries in order to maximize access to foreign markets and sources of supply and to minimize tensions in Japan's relations with foreign governments, including the Soviet Union. As the spirit of East-West detente evaporated in the mid-1970s and Tokyo became more conscious that Japan's actions had an impact on big power relations, the Japanese Government began to emphasize its commitment to the

² The Association of Southeast Asian Nations comprises Indonesia, Malaysia, Singapore, Thailand, and the Philippines.

Japan: Evolving Policy Toward the Third World

Key Judgments

*Information available
as of 1 December 1982
was used in this report.*

Strategic considerations have begun to figure more prominently in Japanese policy toward LDCs as Japan's own view of its national interests evolves and as Tokyo responds to US pressure to play a global role commensurate with its economic power. The Japanese approach, however, continues to be driven by economic imperatives.

Tokyo's reevaluation of policy toward the LDCs was stimulated by Vietnam's invasion of Kampuchea in 1978 and the Soviet invasion of Afghanistan in 1979, which threatened stability in ASEAN and the Middle East. Underlying this, however, is a larger change still under way in Japan's overall foreign policy that reflects growing appreciation of the Soviet threat, a deepening self-confidence stemming from Japan's economic success, as well as US demands that Japan use its economic power to help deal with the Soviet challenge.

Tokyo places a high priority on maintaining stable commercial relations with the LDCs, which are valuable markets for Japan's manufactured exports and supply much of the fuels, foodstuffs, and raw materials indispensable to Japan's survival and industrial growth. Japanese interest thus focuses on the relatively fast-growing East Asian LDCs, the raw material suppliers of ASEAN, and the oil producers in the Middle East. The key policy tool has been economic assistance.

Japanese foreign aid increased rapidly in the late 1970s and, although tight budgets have forced a slowing of the growth rate, Tokyo remains committed to further expansion of aid. Southeast Asia—particularly Thailand, ASEAN's "frontline state"—has been the principal beneficiary of Japanese economic assistance. Japan has also boosted aid to Turkey, Egypt, Oman, and other strategic countries in or adjacent to the Middle East.

International pressure and Japan's own estimate of its strategic requirements will continue to push it toward a more active relationship with the LDCs. The new Nakasone government will, if anything, move further in this direction. Nonetheless, there are limits to how far and how fast Japan will proceed:

- Aid policy will continue to be driven by economic imperatives, and Asia will continue to receive the lion's share of foreign assistance.

- A severe budget crunch is likely to keep foreign aid from expanding rapidly.
- The strategic rationale for economic assistance will remain politically controversial in Japan, as was demonstrated most recently in aid negotiations with South Korea.



Japanese Aid to Strategic LDCs in 1981 *

Million US \$

Asia	1,448 *
ASEAN	1,113
Indonesia	462
Thailand	286
Philippines	234
Malaysia	114
Singapore	18
South Korea	335
Middle East Area	288
Turkey	93
Pakistan	90
Egypt	72
Kenya	15
Somalia	8
North Yemen	4
Jordan	2
Sudan	2
Oman	1
Central America/Caribbean	18
Jamaica	10
Honduras	4
Costa Rica	2
Dominican Republic	1

* ODA, commitment basis.

* Because of rounding, components may not add to totals shown.

Within Asia, more than half of ODA is directed toward ASEAN. The dramatic increase in aid to ASEAN that occurred after the fall of Saigon and the invasion of Kampuchea reflects Tokyo's decision to use economic resources in support of political/strategic objectives (see table 1). Indonesia has ranked first, not only within ASEAN but among all aid recipients, but Thailand—ASEAN's "frontline state"—has benefited most from the new Japanese approach. Between 1976 and 1981 Japanese aid commitments to Thailand grew from \$14 million to \$286 million; Bangkok's share of bilateral Japanese aid grew from 1.4 to 8.3 percent.

Outside of Southeast Asia, Tokyo has boosted aid to a heterogeneous collection of states in and around the Middle East. Although most aid decisions in this area were colored by a desire to stabilize a region crucial to Japan's oil supply, the rationale in each case was usually more complex:

- [redacted] Tokyo committed aid to the Sudan, North Yemen, Oman, Somalia, and Kenya.
- The Soviet invasion of Afghanistan strengthened Pakistan's claim on Japanese aid.
- Tokyo increased aid to Egypt and Jordan because it viewed both countries as essential to the Middle East peace process.
- Turkey, a member of NATO and well outside Japan's traditional area of concern, has nonetheless received Japanese ODA, primarily because Tokyo hopes this will help to burnish its credentials as a member of the Western Club.

Countries in Central America and the Caribbean, although on the periphery of Japan's foreign policy interests, are now receiving more Japanese ODA, albeit still in modest amounts. We believe Tokyo sees Jamaica, the Dominican Republic, Costa Rica, and Honduras as places to demonstrate to Washington that Japan is a cooperative ally. Japan's own interests in Latin America focus on the major raw material exporters of Mexico, Brazil, and Venezuela, which together account for almost half of Japan's trade with the region. Japan's involvement includes far more investments, trade credits, and bank loans than economic aid. Reflecting its belief that Mexico is an important LDC, however, Tokyo is heavily involved in multilateral efforts to solve Mexico's international financial problems.

Over the past decade, the share of Japanese aid going to Africa has increased even though the relative importance of trade with the continent has declined. In part the Japanese are motivated by humanitarian concerns; aid for refugees and for food has increased.

alliance with the United States and its concern over the policies of the USSR. We believe the underlying factors in this process, which is still in progress, include:

- Increasing concern about the Soviet threat stemming from a perceived erosion in the US strategic position and the growing Soviet military presence in East Asia.
- Growing Japanese self-confidence stimulated by the rapid growth in Japan's economic power.
- US demands that Japan use its economic power to help deal with the Soviet challenge.

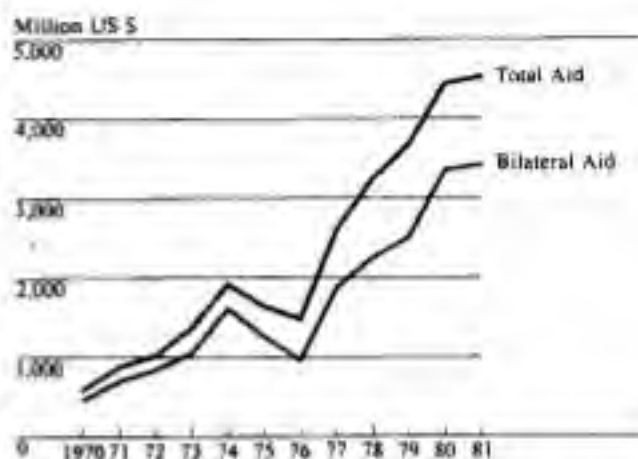
Tokyo never considered military aid or the deployment of military force, because such measures would have violated Japan's constitution and certainly would have aroused the Japanese public and provoked strong attacks from the press and the opposition parties. Instead, the government opted to use economic assistance (supplemented by loans and investment) as its key policy tool for influencing the LDCs. Based on official statements and Japanese Government documents, we believe Tokyo's goals are to:

- Strengthen the economic underpinnings of LDCs and reduce opportunities for Soviet intervention.

Tokyo pledged in May 1978 to double foreign aid over the next three years. In fact, between 1977 and 1980 total Official Development Assistance (ODA) disbursements increased from \$1.4 billion to \$3.3 billion. In January 1981 Tokyo followed up by setting a new goal for ODA of \$21.4 billion in 1981-85, up from \$10.7 billion in 1976-80.

The Japanese Government favors bilateral over multilateral aid. The Japanese want maximum awareness among the recipients of where the aid comes from (see figure 3). Bilateral aid commitments denominated in US dollars increased rapidly in the late 1970s, growing by 33 percent in 1980. Since then, however, the rate of increase has slowed as Tokyo has tried to trim its fiscal deficit and the yen has depreciated against the dollar. In 1981 bilateral aid expanded only 2 percent. Nonetheless, compared with most other

Figure 3
Japan: Foreign Aid Commitments*



* Official Development Assistance (ODA)

government accounts, economic assistance has fared well. In the government's budget for 1983, it will probably increase by about 10 percent.

Shifting Country Focus

Although aid is not accelerating as rapidly as it did during the 1970s, countries of less economic significance and more political importance are receiving greater amounts of aid. The shift is evident in the share of LDC trade accounted for by the 10 top aid recipients. In 1970 the top 10 accounted for 41 percent of Japan's total trade with LDCs; by 1981 only 29 percent.

Although Asian LDCs continue to be the favored recipients, they now receive only about two-thirds of Japan's ODA, compared to 95 percent in 1971.²

² Part of the decline is traceable to the 6-percent share of Japanese aid China received in 1981. As a Communist state, China falls outside the set of LDCs.

As in the Caribbean, Tokyo also wants to demonstrate its international responsibility. In its first involvement in a UN peacekeeping activity, for example, Tokyo has volunteered equipment and civilian personnel to the prospective UN Transition Assistance Group for Namibia [REDACTED]

Egypt—A Case Study

Egypt is a good example of how the Japanese Government is assigning a greater role to political/strategic considerations in its approach to the LDCs. Japanese Foreign Ministry officials believe that Egypt is the pivotal country in the region because of its military, political, and cultural position in the Arab world and because of its critical role in the US-sponsored peace process. Although the country's economic importance to Japan is insignificant—only 0.3 percent of total Japanese foreign trade—Tokyo extended \$71.7 million in aid, representing 2.1 percent of total bilateral aid commitments and 62 percent of Japanese aid to the Middle East in 1981. Japan has provided funds to improve communications, public health, and agriculture and to increase the capacity of the Suez Canal. [REDACTED]

Prospects

International pressure and Japan's own estimate of its national interest will, we believe, continue to push it toward a more active relationship with LDCs. At former Prime Minister Suzuki's request, for example, a Japanese think tank recently completed a study of the Soviet threat to global stability. It concluded that Soviet expansion into LDC areas abundant in energy resources and raw materials constituted a serious threat to Japanese interests [REDACTED]

Nonetheless, there are limits as to how far and how fast Nakasone will move. Economic interests will continue to drive Japan's policy toward the LDCs. We believe Asia—particularly ASEAN—will continue to

receive the majority of Japanese aid, although individual countries will move up and down on the annual list depending on particular projects and priorities [REDACTED]

Slower Japanese economic growth, a severe budget crunch, and adverse shifts in exchange rates probably will keep Japanese foreign aid from expanding rapidly. The Foreign Ministry is already predicting it will be very difficult for Japan to fulfill its pledge to double its aid. Although in absolute terms Japan is now the fourth-largest aid donor, the burden on the Japanese economy was only slightly heavier last year than it had been a decade earlier. In 1980 aid represented 0.32 percent of GNP compared to 0.23 percent in 1971. In 1981, because of a decline in multilateral aid, the ratio was only 0.28 percent. [REDACTED]

In addition to economic constraints, continued domestic political sensitivity to any involvement in the security affairs of other countries will force Tokyo to proceed cautiously. A Japanese diplomat recently explained to US officials during consultations on Africa that Tokyo must "camouflage" the strategic considerations shaping aid policy and in public maintain that aid is motivated by humanitarian concerns. At most, Japanese officials can publicly acknowledge that aid can be used to promote Japan's economic security [REDACTED]

The protracted, acrimonious aid negotiations between Seoul and Tokyo since mid-1981 illustrate the financial and political dilemmas Tokyo occasionally faces in extending aid to strategic LDCs. South Korea, as a neighboring country directly threatened by Communist aggression, is of undoubted strategic importance to Japan. For that reason, Tokyo assembled a five-year \$4 billion package of loans and aid. This was generous by Japanese standards and reflected Tokyo's commitment to maintaining stability on the peninsula as well as its interest in appearing supportive of the US defense commitment to South Korea [REDACTED]

Prime Minister Suzuki, however, had to intervene before the various ministries could agree on the package. Some officials argued that South Korea's

status as one of the relatively wealthy LDCs made it ineligible for large amounts of concessional economic assistance. Still others were worried that giving way to Seoul might stimulate other aid recipients to step up their demands. [REDACTED]

The biggest obstacle, however, was Seoul's insistence on publicly justifying its aid request as Japan's contribution to supporting peace in Korea. Until the South Koreans decided to abandon this approach, negotiations almost broke down. Even so, the textbook controversy this fall has reduced Tokyo's enthusiasm and will probably delay final resolution of the aid issue for several more months. [REDACTED]

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JAPAN-USSR: Response to Soviet Threats

The Japanese protest against Soviet statements about the redeployment of intermediate-range missiles from Europe to Siberia and against Soviet media attacks threatening Japan with nuclear destruction for its close ties with the US was unusually strong. [REDACTED]

Tokyo's protest was directed at Foreign Minister Gromyko's recent statement that, in the event of an INF agreement in Europe, the USSR probably would redeploy some SS-20 missiles to Siberia. The Japanese also rejected recent Soviet media commentary portraying Soviet actions as a response to Japan's efforts to increase defense capabilities and the decision to station US F-16 fighter planes at Misawa in northeastern Japan. [REDACTED]

Comment: Moscow's efforts to influence Japanese public opinion may have been counterproductive. Foreign Ministry officials have told [REDACTED] they were surprised by the heavyhanded Soviet attacks on Prime Minister Nakasone's visits to Washington and South Korea. The Japanese media generally have supported the government's position and have focused on the issue as an example of the USSR's efforts to deflect attention from its own greatly increased military strength in East Asia. [REDACTED]

[REDACTED]

The hostile attitude of the Soviets toward Tokyo's apparent desire to strengthen Japan's defenses probably will not be affected by the protest. The tone of Moscow's rhetoric indicates that an early move to improve relations is unlikely. [REDACTED]

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Department of State

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INCOMING
TELEGRAM

2. USSR-JAPAN: PROPOSED SECURITY ARRANGEMENT.

PRESS REPORTS FROM TOKYO STATE THE SOVIETS, IN A LETTER TO JAPAN'S DEMOCRATIC SOCIALIST PARTY LAST MONTH, SAY THE USSR IS READY TO CONSIDER UNSPECIFIED SECURITY ARRANGEMENTS WITH JAPAN IF TOKYO CONTINUES TO BAN THE PRODUCTION OR INTRODUCTION OF NUCLEAR WEAPONS INTO JAPAN. THE LETTER BLAMES THE US FOR THE CURRENT ARMS RACE AND EMPHASIZES THE USSR WILL NOT DISARM UNILATERALLY. SIMILAR LETTERS HAVE BEEN SENT TO MEMBER PARTIES OF THE SOCIALIST INTERNATIONAL, ACCORDING TO A SPOKESMAN OF THE DEMOCRATIC SOCIALIST PARTY.

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COMMENT: //MOSCOW PRESUMABLY IS OFFERING A REVISED VERSION OF THE "NONNUCLEAR" PACT THAT BREZHNEV FIRST PROPOSED LAST MARCH. PRIME MINISTER NAKASONE ALMOST CERTAINLY WILL REJECT THE PROPOSAL AS ANOTHER ATTEMPT TO DRIVE A WEDGE BETWEEN THE US AND JAPAN, BUT HE MAY FIND IT DIFFICULT TO PROVIDE A PERSUASIVE RATIONALE TO THE MANY JAPANESE WHO ARE OPPOSED TO NUCLEAR WEAPONS. RECENT COMMENTS BY SOVIET OFFICIALS [REDACTED] SUGGEST THE USSR DOES NOT EXPECT AN IMPROVEMENT IN BILATERAL RELATIONS ANY TIME SOON. //

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Japan: Marking Time in Economic Relations With the USSR [REDACTED]

An Intelligence Assessment



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~~E4 82-10093~~
~~June 1983~~

Japan: Marking Time in Economic Relations With the USSR [REDACTED]

Key Judgments

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Moscow's harsh reaction to Prime Minister Nakasone's moves to strengthen ties with the United States, particularly in the military field, and Tokyo's hardline response militate against any significant improvement in relations for some time to come. [REDACTED]

Domestic pressure for better economic relations is at a low point. Business interest in the Soviet market has faded as recession and other problems have reduced demand for Soviet raw materials and energy. The Japanese Government and private investors in the Sakhalin offshore oil and gas project do appear determined to move ahead, although prospects for new Siberian resource development projects are dim. In 1983 total trade between Japan and the Soviet Union is likely to rise at well below the 16-percent rate (year-to-year comparison of yen values) of 1982. [REDACTED]

The Nakasone administration's efforts to strengthen ties with the United States have also produced a willingness to cooperate in the enforcement of economic sanctions against the USSR. The Japan Export-Import Bank has made no major new commitments to Moscow since the declaration of martial law in Poland. Enforcement of export controls recently has been tightened. On other East-West issues [REDACTED]

The real test of Nakasone's willingness to subjugate economic interests to broader political objectives will come two or three years from now, when domestic business conditions have improved and some of the current pessimism surrounding future demand for resources and energy has

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dissipated. Nakasone then may have to compromise with domestic advocates of expanded economic ties with Moscow by permitting increased activity on the private level. Japanese banks are showing increasing interest in the Soviet Union as a potential borrower and are likely at some point to lobby for removal of existing guidance against direct loans. A substantial expansion of trade would then be possible without any relaxation of the existing curbs on official financing. [REDACTED]

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Japan: Marking Time in Economic Relations With the USSR ■

The Political and Security Setting

Japanese-Soviet political relations are now at a low point, with little prospect they will improve soon. Although mutually profitable economic relations have provided an element of stability and an incentive for dialogue between the two governments, economic circumstances have changed. Moreover, security issues have assumed a more prominent place in the relationship as Prime Minister Nakasone has moved to strengthen the US-Japan alliance. Tokyo has also expressed concern about Soviet deployment of SS-20s and Backfire bombers in the Far East. ■

Security Concerns

More than any of his predecessors, Nakasone has made security issues a major government concern. He has said that Japan must have the military capability to defend itself in a conventional war and must be capable "of contributing in some measure to the security and well-being of other states." Some Japanese officials, particularly in the Ministry of Foreign Affairs, had worried that the new Prime Minister's penchant for personal diplomacy might lead to an initiative to improve relations with Moscow. They have found, instead, that Nakasone was willing to use the Soviet military buildup in Asia, the Northern Territories issue, and the SS-20 issue to bring attention to Japan's security problems. In his first few months in office, for example, he increased defense spending by 6.5 percent, improved relations with South Korea, decided that Japan should make technology available to the United States for military applications, ■

■ referred to closing the approaches to the Sea of Japan in wartime, and in general left no doubt that strengthening the alliance with the United States and shoring up Japan's defense capabilities were personal priorities. ■

Even before Nakasone took office, the Soviet Union had registered concern about the increase in defense expenditures by the Suzuki administration and the

closer strategic cooperation between the United States, Japan, and China in the Far East. On the eve of Nakasone's accession, the Soviet Embassy in Tokyo protested Japan's decision to allow the basing of US F-16s at Misawa. Nonetheless, the Soviet media gave the new Prime Minister a month's grace, mixing praise for his experience and influence as a politician with reminders of his past support for revising Japan's constitutional prohibition against war as an instrument of foreign policy and his support for a strong Japanese military. ■

In January, however, Moscow switched to a harsh propaganda campaign and threatened to use force in an effort to counter Nakasone's move toward closer military cooperation with the United States and improved relations with South Korea. In response to the remark about the "unsinkable aircraft carrier," a TASS report on 19 January carried threats of possible nuclear attack against Japan. Two days before that, in Bonn, Soviet Foreign Minister Gromyko for the first time publicly raised the issue of redeploying SS-20s to the Far East. Articles denouncing the revival of Japanese militarism and the threat it posed to other Asian nations began to appear with increasing regularity in the Soviet press. ■

As part of an effort to turn Japanese public opinion against increased military cooperation with the United States, the Soviet Embassy in Tokyo sent letters to two opposition parties in Japan promising that the Soviet Union would not launch a nuclear strike against Japan as long as Tokyo observed its three nonnuclear principles—no possessing, producing, or permitting the introduction into Japan of nuclear weapons. At the same time, by charging that nuclear-equipped US forces were already based in Okinawa, Moscow implied that the nonnuclear principles were not being faithfully observed and that the Japanese people should not be content with the policies of the Nakasone government. ■

The Northern Territories

In addition to the increased interest in security issues, Tokyo has taken every opportunity to press the USSR strongly for the return of the Northern Territories. On 23 April, Nakasone and Chief Cabinet Secretary Gotoda reaffirmed Tokyo's longstanding demand that the Soviet Union return the Northern Territories—three small islands (Kunashiri, Etorofu, and Shikotan) and a small archipelago (the Habomais)—to Japanese control.

Japanese officials have repeatedly emphasized that bilateral relations will not improve substantially until the Soviet Union at least recognizes the existence of a territorial issue. Japanese diplomats keep the issue front and center by insisting that Foreign Minister Gromyko visit Tokyo before any high-level Japanese official visits Moscow. The Soviets have countered since 1978 that a Gromyko visit can take place only after the proper "atmosphere" is created and some possibility of a breakthrough on political issues is imminent. In other words not until they receive assurances that the Northern Territories issue will not be raised and Tokyo displays some interest in negotiating a Good Neighbor treaty, confidence-building measures, or a "no nuclear" weapons agreement.

The Political Setting

Tokyo faces little domestic opposition to its policy on the Northern Territories and generally believes the onus is on Moscow to improve bilateral relations. This unusually hardline consensus owes much to the harshness of Moscow's actions and statements in recent months.

The Economic Relationship

The increased salience of security issues on both sides of the bilateral relationship comes at a time when the prospects for improved economic ties are uncertain. Exports continue to grow—by almost 36 percent in 1982—but imports declined by 7 percent. Tokyo, meanwhile, shows diminishing interest in deepening Japan's involvement in the Soviet economy. For one thing, Japan's raw material and energy requirements have been reduced by recession and structural changes in the economy. Acting in tandem with the United States and NATO, Tokyo imposed sanctions against the USSR after the Soviet invasion of Afghanistan. The sanctions included:

- Restrictions on official export credits to the Soviet Union.
- Reaffirmation of a ban against the export of high-technology items included on the COCOM list.
- Restrictions on contacts between high-level government officials.

Although the restrictions on export credits and official contacts have been relaxed to some extent, they remain an impediment. Japan's current insistence that Gromyko visit Tokyo before high-level Japanese visitors go to Moscow enforces a tacit limit on diplomatic contacts. Tokyo continues to observe the letter of the COCOM restrictions and recently has begun to discourage some types of transactions not yet officially on the list.

In the case of official export credits, Tokyo has modified its policy from time to time to assuage private-sector complaints that Japanese restraints are more severe than those observed by West European countries. But Tokyo has done so without destroying the framework of the sanctions. In September 1980, for example, Tokyo decided that the sanctions applied only to new credits and approved an extension of

buyers credits to support a \$40 million supplement to the South Yakutsk coking coal project and the third phase of the Siberian timber project. Stretching the old-new distinction even further to accommodate a major business interest, Tokyo justified Japan Export-Import Bank credits to finance the sale of large-diameter pipe on the ground that the pipe was part of an ongoing series of transactions. Approximately \$160 million has been allocated to finance pipe sales in fiscal year 1983, which began in April. Modifications also have been made as West European governments and the United States eased sanctions. ■

One measure of the continuing efficacy of the export credit sanction is that Japanese firms have signed only one plant export contract in excess of \$100 million since 1980. Since Tokyo reaffirmed its commitment in early 1982 to restrict export credits after the declaration of martial law in Poland, the Japan Export-Import Bank has made almost no new commitments to finance plant exports. ■

Export Credit Policy

Japan is also cooperating with US efforts to tighten the terms under which official credits are granted. In recent negotiations, the Ministry of Finance insisted on strict observance of OECD guidelines on interest rates. Tokyo does argue, however, that the current premium of 0.3 percentage point that it must add to the long-term prime rate (now 8.4 percent) in calculating the rate for Export-Import Bank loans makes official financing more expensive than loans from private banks. ■

Moscow has responded by waging an increasingly intense campaign to undermine domestic support for Tokyo's hard line on official credits. Rather than protesting directly to the government, the Soviets have attempted to mobilize the Japanese business community to push for a change. One tactic is to remind businessmen that Japan, which was once the

USSR's second-largest Western trading partner, is now fourth and has lost ground to European competitors because, unlike France and West Germany, it has refused to separate trade from political issues. ■

We believe the Soviet campaign is almost certain to fail barring an unforeseen shortage in Japan of energy or resources. The business community is not of one mind over the need for government initiatives to improve economic relations with the USSR. ■

The Ministry of Finance, the final authority within the bureaucracy on export credits and financial issues, has no interest in upsetting its excellent relationship with US financial authorities for the relatively small gains that would come from easing sanctions. Even the Ministry of International Trade and Industry (MITI), the traditional promoter of expanded trade, is relatively inactive at the moment, perhaps because it is under so much pressure from Washington on other issues. ■

Private Financing. Trading companies have minimized the effect of the decline in Japan Export-Import Bank lending to the Soviet Union on trade by financing more of the trade themselves. ■

reflects the suspicions of trade officials and businessmen that Washington hopes to cripple existing Japanese trade and resource development deals with the USSR and close off potential markets for new Japanese industries. [REDACTED]

Tokyo also resists some parts of the US proposal to control equipment and technology related to the oil and gas industry. The proposed monitoring requirements for pipeline-related equipment in particular hit Japan's steel and machinery industries hard. We suspect Tokyo is also concerned that parts of the proposal might impede completion of the Sakhalin offshore oil and gas development project. [REDACTED]

Declining Interest in Resource Development

Resource development projects in the USSR have lost most of their luster for the Japanese. Their industrial structure has undergone such a vast transformation as a result of higher energy prices that even the scale of existing projects to import raw materials from the Soviet Union is beginning to appear excessive. [REDACTED]

In some cases, the inconsistency of Soviet policies has dampened interest. Japanese businessmen were prepared to move ahead with a pulp and paper complex on Sakhalin two years ago, but the Soviets said no. [REDACTED]

Protecting Existing Economic Interests

Although not actively pushing economic ties with Moscow, Tokyo does not want to damage existing interests. On the question of broadening the scope of COCOM restrictions, for example, Tokyo is suspicious of US motives. Reporting in the Japanese press

The Soviets also have recognized that prospects for large-scale development projects are bleak.

Soviet officials are now talking about the possibility of launching "miniprojects" to develop Siberian resources. The concept is too ill defined, however, for the Japanese to consider it seriously.

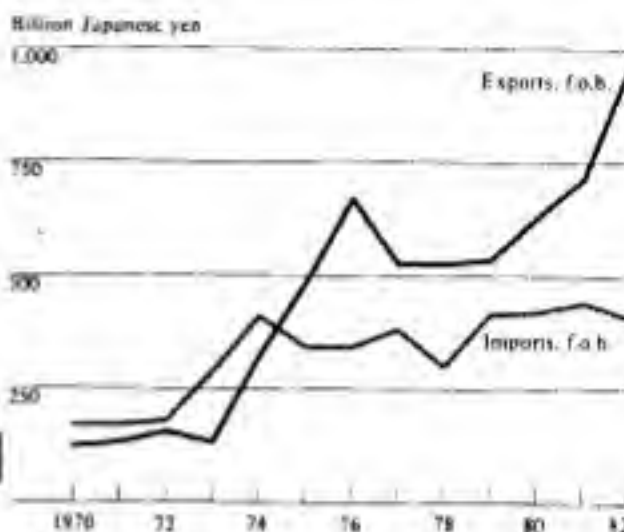
Only the Sakhalin offshore oil and gas project has any momentum at present. The oft-delayed exploratory phase of the project should be completed this summer. Tokyo, prodded by a consortium of major firms and banks that has \$100-200 million invested in the project, remains committed to proceeding with the development phase, even though the utility companies, the ultimate consumers of the liquefied natural gas (LNG) portion of the output, appear to have adequate supplies assured into the early 1990s.

From the government's perspective the project is another opportunity to diversify sources of LNG. Japan now depends on Indonesia for 45 percent of its natural gas. Moreover, Sakhalin is closer to Japan than Alaska, Australia, or Malaysia, and it does not pose the same risk of political instability as Abu Dhabi and Indonesia. Sakhalin would provide LNG at prices lower than those available from many alternative suppliers, not only because of discounts built into the contract, but also because Moscow has a record of underpricing competitors to ensure a market for its gas. Equipment sales will also provide employment opportunities in Japan. Soviet hard currency earnings from the project, which could exceed \$1 billion a year in the mid-to-late 1990s, could also pay for a substantial increase in Japanese exports to the USSR.

Trade

Trade with the Soviet Union is growing but is still relatively unimportant to the Japanese economy. In 1982 total trade between the two countries rose 16 percent in yen terms (see figure 1) and 6.7 percent in US dollars to \$5.3 billion. The Soviet Union, however, accounted for only 2.1 percent of the value of Japan's total foreign trade, and the Soviet share in any given year has never exceeded 3 percent. With the exception of platinum-group metals and nickel, Japan's dependence on the USSR for supplies of individual imported commodities remains low. On the export side only two

Japan: Trade With the USSR



Japanese industries—steel and machinery—have important stakes in the Soviet market. The Japanese enjoy substantial annual trade surpluses—\$2.2 billion in 1982.

Japan's growing trade surplus may become an impediment to further expansion of trade with the USSR. Although in deficit with Japan, the Soviet Union is running surpluses in trade with West European countries. Italy has already complained to Moscow that its deficit is in effect financing Japan's exports to the USSR. The Italians are demanding that the Soviets grant them a larger share of pipeline-related contracts to correct the imbalance. Japanese businessmen expect other West European countries will make similar demands. The Soviets are likely to respond; they generally seek bilateral balance in their trading relationships.

Exports. The value of Japanese exports to the USSR rose by 35.6 percent (year-to-year comparison of yen values) to \$3.9 billion in 1982. Producer goods made up the majority of Japanese shipments; iron and steel alone were worth \$1.7 billion—over 40 percent of all exports. Large-diameter pipe for natural gas pipelines, seamless pipe for oil wells, steel plate for the manufacture of large-diameter pipe, and special steels were the principal iron and steel products. Japanese industry expects the volume of steel exports to remain high as work on the Siberia-Western Europe and Soviet domestic gas pipelines continues. Shipments of large-diameter pipe should remain at 1 million metric tons per year for at least two more years. Plate shipments exceeded 540,000 tons in 1982; according to a Japanese industry newspaper, the Soviets are seeking an assured supply of 600,000 to 700,000 tons a year. [REDACTED]

The worldwide recession has increased the importance of the Soviet market to Japan's steel industry. The Soviets purchased 8.8 percent of the industry's total exports, as compared with 6.9 percent last year and 5.5 percent in 1980. Dependence on the USSR for export sales should drop back into the 5- to 6-percent range once markets improve elsewhere. By product, Japanese dependence on the Soviet market is greatest in the case of large-diameter pipe. The Soviet Union has been the principal buyer of this item for many years. [REDACTED]

Japan's machinery exports to the Soviet Union rose by almost 58 percent to \$1.5 billion in 1982. Unlike in the past, when plant exports accounted for the growth, construction machinery, cargo-handling machinery, and dump trucks led the way. Japanese observers note that the Soviets are buying much of this machinery as part of Phase III of the Siberian timber resources project. The timber resources development contract signed in March 1981 specified that plant and equipment purchases had to be made within two years. [REDACTED]

Machinery exports probably will decline this year. Demand for machinery to be used in timber resources development will plummet [REDACTED]

[REDACTED] Soviet officials have expressed interest in smaller scale plants to produce electronic goods and in automated production facilities, but actual exports will be limited by Tokyo's adherence to COCOM. Japan's Ministry of Foreign Affairs has refused visas to Soviets seeking to visit facilities containing sensitive technology, and MITI is taking measures to upgrade COCOM enforcement. [REDACTED]

Machine tools essential to improving industrial productivity are a substantial percentage of exports to the USSR. The Soviets purchased large numbers of grinding machines and machining centers in 1982. The Soviets also rely on Japanese suppliers for numerical controls and industrial robotics. Kawasaki Heavy Industries, for example, has sold 42 spot welding robots for use in motor vehicle assembly in the last three years, according to a US businessman. Nonetheless, the Soviet market is not of great importance to the machine tool industry as a whole; shipments were only 4 percent of Japanese machine tool exports in 1982. In the case of individual firms, few if any depend on the Soviet Union as a market. [REDACTED]

Imports. The value of Japanese imports from the Soviet Union fell in 1982 by 7 percent to \$1.7 billion (c.i.f.). The drop reflected falling demand induced by recession and falling prices for semimanufactured goods and raw materials, which have traditionally accounted for more than half of the value of imports. The USSR accounts for only 1.3 percent of Japan's total import bill. Prospects are not good for a turn-around soon. [REDACTED]

Table 1
Japan: Imports of Nonmonetary Gold

	Worldwide		From the USSR	
	Quantity (tons)	Value (FOB) (Million US \$)	Quantity (tons)	Value (FOB) (Million US \$)
1976	63	250	0.3	1
1977	47	223	1	6
1978	81	498	5	31
1979	53	426	4	41
1980	28	524	2	46
1981	172	2,425	37	535
1982	143	1,514	32	348

A substantial part of the decline in the value of imports is linked to a fall in the price of gold, which accounted for 24 percent of all Japanese imports from the Soviet Union in 1982. Small amounts of Soviet gold also may have reached Japan indirectly through the London and Zurich markets, the largest sources of Japanese imports. Over two-thirds of the fall in the value of direct gold imports from the USSR is attributable to a decline in the price of gold. Japanese buy gold primarily as a financial asset. Consequently, a downward movement in the world price reduces its attractiveness as an investment and cuts import volume.¹

In 1982, wood was again Japan's leading import from the USSR, having been temporarily displaced by gold in 1981. Wood imports are especially important to the pro-Soviet lobby. Member firms in the association that handles 80 percent of the trade channel part of their profits to the Japan Socialist Party and other

promoters of better Japanese-Soviet relations, according to a recent Japanese magazine article. As table 2 shows, however, recession and a stagnant housing market in Japan have taken their toll. Japan imported only \$396 million worth of logs, lumber, and wood pulp in 1982, compared with \$747 million in the peak year of 1980 and \$485 million in 1981. Here, too, much of the decline is the result of a fall in prices. The price of pine logs, for example, fell by 34 percent between 1980 and 1982.

Japan's wood imports should increase modestly in 1983. Housing investment turned upward in the fourth quarter of 1982 and is expected to continue rising in early 1983. For the year the increase in housing investment should be 6 to 7 percent. Less certain, however, is the Soviet Union's ability to maintain its share of the market. Japan's total wood imports rose in value approximately 11 percent in 1982, while the value of Soviet shipments declined substantially.

The Soviet Union continues to be a major supplier of platinum-group metals—platinum, palladium, and rhodium—which are essential to Japan's advanced technology sectors. By value the Soviet Union supplies 46 percent of Japan's rhodium, 55 percent of its palladium, and 24 percent of its platinum. Imports of

¹ Japan became a major market for gold in 1981, the first year Japanese citizens were allowed to buy gold freely. Gold trading got another boost in April 1982, when major commercial banks introduced passbook accounts for gold. Gold is an appealing investment for Japanese who wish to evade taxes because dealers are not required to report transactions to tax officials. This reason for investing was especially compelling in 1981 and 1982 because the Ministry of Finance was threatening to close a loophole that has allowed people to invest billions of dollars illegally in tax-exempt savings accounts. The Diet, however, postponed implementation of the Ministry of Finance's plan for five years. Most people probably will choose to keep their money in the interest-earning savings accounts for a few more years, thus reducing the potential demand for gold.

Table 2
Japan: Wood Imports From the USSR

	Value (FOB) (Million US \$)	Percent of Total Wood Imports
1976	416	12
1977	538	14
1978	528	13
1979	732	10
1980	747	9
1981	485	10
1982	396	8

platinum group metals were worth \$114 million in 1982. Dependence on the Soviet Union for other metals is low. As a rule of thumb, Japan tries to keep its dependency on the USSR below 20 percent. Only in the case of nickel is dependency at this level. Nickel, however, presents no real problem. Canada is the largest supplier, and the Philippines, Australia, and the United States are alternative sources.

Prospects

In the immediate future, we expect Prime Minister Nakasone to uphold the need for a common front among Western nations in dealing with the USSR. Nakasone appears to share the view of the Ministry of Foreign Affairs that closer cooperation among Western countries will, over the long term, strengthen Tokyo's position in dealings with Moscow.

Nakasone's interest in a common approach extends to the INF negotiations. We believe the sudden expression of high-level Japanese concern about the INF negotiations and the basing of SS-20s probably has less to do with the potential threat from the USSR than with the need for reassurance that the United States gives as much priority to the defense of Japan and the western Pacific as it does to the defense of Western Europe and the Atlantic.

Recession and, more recently, the Levchenko allegations have spared Nakasone the hard decisions usually necessary to bring export credit and control policies into line with a tougher political stance toward Moscow. The real test of Nakasone's willingness to subordinate economic interests to broader political objectives such as the recovery of the Northern Territories will come two or three years from now, when domestic business conditions have improved and some of the current pessimism surrounding future demand for resources and energy has dissipated.

Nakasone will not, in our view, turn away from Japan's commitment to a harder line politically. He will, however, eventually have to compromise with the advocates of expanded economic ties with Moscow by permitting increased activity on the private level. Japanese banks are showing interest in the Soviet Union as a potential borrower and are likely at some point to lobby for removal of the Ministry of Finance guidance against direct loans. If the Sakhalin offshore project and the Siberian-Western Europe pipelines move ahead, the Soviet Union would be in a better position to repay long-term credits. Thus, it is quite possible that commercial banks could displace the Japan Export-Import Bank as the primary supplier of credit for plant exports and smaller resource development projects. A substantial expansion of trade would then be possible without any relaxation of the existing curbs on official financing.

Dialogue Picks Up

The flurry of official and private consultations with the Soviets that begins today reflects Japan's desire to ease tensions in bilateral relations, but movement on the key issues dividing Moscow and Tokyo is unlikely

The Soviets and Japanese have not had such a full schedule of talks since the invasion of Afghanistan. Tokyo bills the meetings as a "breakthrough" in Foreign Minister Abe's "creative diplomacy." According to press reports, Foreign Ministry officials hope the exchanges will pave the way for a visit by Foreign Minister Gromyko. In private, however, they do not foresee much improvement resulting from these meetings and believe a thaw cannot be expected until after the US presidential election, when they hope US-Soviet relations will improve.

The Soviets have stressed their willingness to resume contacts but have warned that only "practical deeds" can reduce tensions. They have shown no sign of moderating their propaganda campaign against Japanese "militarism" and in private talks with Japanese officials have displayed no flexibility.

Gromyko said in mid-July that signs of Japanese independence of the US would be the touchstone of Moscow's future policies.

Comment: Both Abe and Prime Minister Nakasone, aware of popular uneasiness over Japan's tense relations with the Soviets, are using this diplomatic posturing to strengthen their positions before the ruling party elects its president in November. They probably see the consultations as paving the way for seizing opportunities that might open up if US-Soviet relations begin to improve.

Moscow does not expect the increased dialogue with Tokyo to alter the close relationship Nakasone has forged with the US but may hope it will encourage the Japanese to moderate their position on mutually contentious issues.

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TCS 2892/84

16 August 1984

Scheduled Meetings Between Japanese and Soviets

Participants	Subject	Dates	Venue	Comment
Official				
Working-level Foreign Ministry officials	Middle East/Gulf War	16-17 Aug	Moscow	First consultations on Middle East
Cabinet ministers Yamamura and Kamentsev	Fishery issues	16-22 Aug	Moscow	Yamamura first cabinet minister to visit USSR since Chernenko took office
Representatives from Supreme Soviet and Japanese Diet	Bilateral relations	October	Tokyo	First since Afghanistan
Government-sponsored Japanese film festival	Cultural	Uncertain	Soviet Union	First in six years
Private				
Former Foreign Minister Sakurauchi and (possibly) Gromyko	Bilateral relations	28 Aug-2 Sep	Moscow	Sakurauchi chairman of Nakasone faction and new chairman of Dietmen's League for Friendship with Soviet Union
Domel Labor Federation and Soviet General Council of Trade Unions	Labor issues	Late August	Soviet Union	First Domel mission to USSR since 1973
Japan-USSR Joint Economic Committee	Trade	Autumn	Tokyo	First meeting since Afghanistan
Japan-USSR Round Table Conference	Bilateral relations	October	Moscow	Has met periodically since 1979

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USSR-JAPAN:

Soviets Make Show of Flexibility

Nov 9 1984

The Soviets are striving to appear flexible in their dealings with Japan while privately remaining intransigent on the Northern Territories issue. [REDACTED]

The TASS account of the meeting in New Delhi on Sunday between Premier Tikhonov and Prime Minister Nakasone says that Tikhonov noted that "practical steps by both sides" are needed to improve strained relations. Vadim Zagladin, the first deputy chief of the Soviet Communist Party's International Department, took the same line at a press conference in Tokyo last week, stating that a visit by Foreign Minister Gromyko is still on the agenda. [REDACTED]

Japanese Foreign Ministry officials regard the meeting with Tikhonov as significant because Nakasone was one of the few Western officials whom Tikhonov met while attending Mrs. Gandhi's funeral. The Japanese say Tikhonov displayed no flexibility on the Northern Territories issue, while urging Japan to conclude economic and cultural agreements and a "good-neighbor" treaty. Nakasone reportedly told the Premier that Japan will discuss new agreements only if Gromyko visits Tokyo and addresses Japan's territorial claims. [REDACTED]

Comment: Moscow's new interest in high-profile contacts with Japan is an attempt to appear responsive to Nakasone's recent efforts to expand the dialogue. The session in New Delhi was the first such meeting since former Prime Minister Tanaka visited Moscow in 1973. [REDACTED]

The continuing stalemate in Sino-Soviet relations and signs of North Korean interest in better relations with Japan also may be contributing factors. Moscow may hope that playing to public opinion in Japan will encourage some movement by Tokyo. There is no evidence, however, that the Soviets will offer concessions regarding the Northern Territories. [REDACTED]



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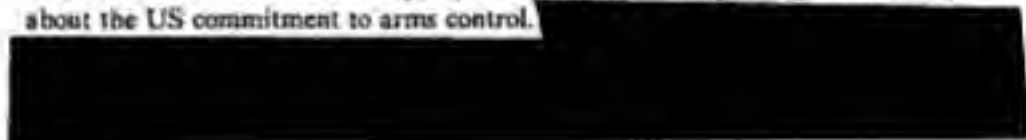
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Northeast Asia

Japan Gears Up for Disarmament Conference

Japanese political groups and the media are increasingly touting their support for disarmament as the Second UN Special Session on Disarmament approaches. An anti-American tone could develop, especially in view of the growing doubt in Japan about the US commitment to arms control.



In Defense of the Yen

Contrary to recent press reports that Japan's actions have been purposely designed to undervalue the yen, Tokyo's short run policy is designed to inhibit yen depreciation. Defending the yen is consistent with Tokyo's primary economic goals of maintaining low inflation, encouraging domestic demand, and alleviating trade pressure. Unlike the mid-1970s, official intervention in foreign exchange markets has been modest, indicating authorities are smoothing out day-to-day fluctuations and not holding the yen at any particular peg point. [REDACTED]

So far this year, Bank of Japan intervention has been in support of the yen. In fact, Bank officials had hoped to lower the official discount rate to 4.75 percent to stimulate domestic activity but are holding off in the belief such a move would lead to further depreciation unless US interest rates also fall. The Finance Ministry also is asking Japanese insurance companies to delay foreign portfolio investments in order to slow the outflow of dollars. Nevertheless, since 1 January the yen has depreciated 6.4 percent against the dollar. [REDACTED]

[REDACTED]

[REDACTED]



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**Briefing Materials for the
President's Meeting With
Prime Minister Nakasone,
2 January 1985** [REDACTED]

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Briefing Materials for the
President's Meeting with Prime
Minister Nakasone, 2 January 1985

C O N T E N T S

Nakasone's Meeting with the President.....	1
<u>Tensions and Tactics</u>	
Limits to Japanese Flexibility.....	3
How Japan Will Play the United States.....	6
<u>Political Setting</u>	
Nakasone's Political Standing.....	10
Objectives of Nakasone's New Administration.....	14
<u>Selected Issues</u>	
Japanese Interest in Disarmament.....	17
Japan's Relations with the Soviet Union.....	19
Japan and China--Growing Strategic and Economic Ties.....	21
Japan and the Two Koreas.....	23
Pacific Basin Economic Cooperation.....	25
Japan's New Initiatives in Africa.....	27
Financial Liberalization.....	29
Status of Software Protection Legislation.....	31
Liberalization of Japan's Telecommunications Market.....	33
The Defense Spending Limit.....	35
Japanese Defense Procurement.....	37
Defense Technology Transfer.....	39
Controlling Technology Loss.....	41
Economic Growth and Budget Issues.....	43
Matrix on the Status of Economic Issues.....	45



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21 December 1984

Nakasone's Meeting with the President [REDACTED]

Shortly after forming his new Cabinet in early November, Nakasone said that the period before President Reagan's inauguration was "more important than generally realized" because the President would be formulating his second administration's policies. We believe Nakasone wants to use his January visit to forestall basic changes in US policy toward Japan in order to buy time to deal with domestic issues. [REDACTED]

Nakasone and the Foreign Ministry do not expect Washington to raise the defense issue during his visit but anticipate that trade issues will be a major item on the US agenda. Nakasone has established a special committee to deal with international economic issues [REDACTED]

-- Other ministries see less urgency, however, believing trade will not be a problem until the second half of 1985 because the recovery has kept US unemployment down. [REDACTED]

Nakasone probably will point to the new committee and progress on bilateral issues during his first two years as indications of his sincerity in working to resolve trade differences.

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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Limits to Japanese Flexibility [REDACTED]

A more assertive approach that reflects Japan's growing self-confidence as an independent world power will temper the Prime Minister's inclination to make concessions to the United States. Nakasone may be increasingly sensitive on this score. His ability to smooth relations through his personal ties with the President is admired [REDACTED]

With the bilateral current account surplus likely to be over \$30 billion this year and even higher next, trade friction will continue to trouble the relationship.

- Tokyo's effort to reduce its budget deficit will prevent expansionary government spending that could stimulate domestic demand--an essential ingredient for import growth.
- Revenue shortfalls will stall any wholesale tariff reduction and may mandate excise taxes that could put US products at a disadvantage. [REDACTED]

Tokyo's increasing unwillingness to respond to what it perceives as the unreasonable demands of US special interests will be the most serious limit to its flexibility in dealing with trade differences. Press reports and public opinions polls indicate the Japanese believe their markets should be more open, but there is a consensus that the trade imbalance with the United States is not Japan's fault. Rather, Tokyo sees it as the result

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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of the strong dollar created by high US interest rates. In addition, Tokyo believes that the flow of funds and goods from Japan has helped fuel the US recovery. [REDACTED]

The government's agenda for economic restructuring could exacerbate trade friction. Competition between Japan and the United States in technology markets and Tokyo's practice of protecting some of its less competitive sectors already create tensions.

- MITI--seeking to promote the domestic software industry-- is still working on software protection legislation that would include provisions objectionable to the United States.

[REDACTED]

- The Japanese are committed to domestic satellite development to spur scientific research and for nationalistic reasons. US arguments against uneconomic indigenous production carry little weight with Tokyo, which will continue to protect government-related satellite programs.
- Policies that protect both depressed industries and the cumbersome distribution system are essentially social welfare programs designed to bolster employment. For political reasons, they probably cannot be eliminated.

We believe new or evolving areas, such as high technology, telecommunications, and finance, where interest groups in both Japan and the United States are still fluid, offer the best opportunities for relatively quick action to ease trade differences. [REDACTED]

Japan's dependence on trade for vital resources and for economic expansion could lead Tokyo to respond to pressures from other countries that run counter to US interests.

- The Japanese will increasingly join the EC and ASEAN to oppose US "protectionist" moves.
- Japan is under pressure to open markets to US competitors, such as Australia.
- Japan's need to diversify energy supplies will encourage continued trade with partners such as Iran and raise the prospect of new politically sensitive ventures, such as those that could result from the reported Japanese interest in oil in Vietnam.

- Tokyo may attempt to improve ties with the Soviet Union by encouraging trade as a leadin to better political relations. Japan will probably provide financing for the Sakhalin natural gas project if the Soviets can produce an investment plan and find Japanese buyers for the gas.

Nakasone has only limited flexibility on defense, although no likely successor is as well disposed toward US views on security matters. As with prime ministers before him, Nakasone places a premium on the Security Treaty with the United States, but in contrast he also believes Japan should improve its own defense capabilities. His personal ability or that of any prime minister--no matter how sympathetic--to make significant changes in defense policy, however, is questionable.

- Because defense remains a politically charged issue in Japan, the Prime Minister's rivals in the LDP can use it against him--which prevents him from moving too far ahead of the consensus within the party.
- Most Japanese believe the current effort on defense is adequate, making major changes in security policy unlikely, in our view, unless Tokyo faces an unequivocal foreign challenge--such as a dramatic change in the Soviet threat or fundamental uncertainty about its security relationship with Washington.
- Furthermore, budget cuts in various politically sensitive areas--agriculture, local government, construction, and transportation--will make Tokyo reluctant to increase defense spending beyond 1 percent of GNP.



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21 December 1984

How Japan Will Play the United States

The Prime Minister's major objective during his discussions with the President will be to contain disagreements over trade and defense and demonstrate to his countrymen his continued ability to manage the US-Japan relationship. The Nakasone administration will use several time-tested strategies. [REDACTED]

Sidetrack the United States by encouraging discussion of less sensitive issues. An agenda filled with issues that are not central to Japanese concerns is suited for this purpose--hence the alacrity with which both the Prime Minister and Foreign Minister have seized on the Pacific basin and African relief. Talks on nuclear disarmament and global economic recovery also serve this purpose. [REDACTED]

Try to ease US pressure on trade and defense by emphasizing action in other areas. Tokyo may assemble a list of "favors" Japan has done for the United States to accentuate the positive, turn attention from bilateral disagreements, and encourage US tolerance for a go-slow Japanese approach on pending US requests. The list could include:

- Increased economic assistance, particularly for LDCs designated "strategic" by the United States.
- Backing for the Caribbean Basin Initiative.
- Favorable votes in the United Nations and other world bodies on issues of concern to the United States. [REDACTED]

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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On trade, emphasize progress to date or turn pressure back on Washington. If efforts to avoid discussion of differences over trade fail, Tokyo will point to promotion of Japanese direct foreign investment, export restraints, and trade packages that incorporate generalized promises and small tariff reductions.

[REDACTED]

- He probably will offer to extend auto export restraints-- at least informally--if Washington desires.
 - Japan announced a new trade package in mid-December containing advanced implementation of Tokyo Round tariff reductions--largely directed at the LDCs.
 - Nakasone will stress the importance of Japanese investment in the United States and might mention the unitary tax issue and barriers to investment posed by the Defense Department for national security reasons.
 - He will cite recent progress on financial liberalization and standards and point to the potential for US sales created by the liberalization of the telecommunications market.
- [REDACTED]

On defense, claim that significant departures in defense policy would arouse Japanese and Asian fears, assert that Japan cannot afford to do more, and keep US attention focused on the defense budget. In our view, domestic and Asian concerns do exist, but they are not as serious as the Japanese portray. A bigger problem is the conservatives' reluctance to pay for a stronger defense.

[REDACTED]

In portraying budget difficulties, rather than military requirements, as the key factor that shapes Japan's defense efforts, Tokyo is describing one of its objective political realities. But the Japanese also use this explanation to avoid unpleasant questions concerning Self-Defense Force military capabilities. The Japanese probably will point to:

- Steady increases in defense spending--but gradual and from a very low base.
- Dramatic personal intervention by the Prime Minister to secure additional appropriations--but in minute increments.
- Preparations for breaching the 1-percent barrier--without reference to the small sums involved.

Support for relatively low cost efforts to improve bilateral military cooperation has served a similar purpose in the past.

The Japanese try to use more effective joint military planning and exercises, agreement on defense technology transfers, purchases of US military equipment, strong host-nation support--all intrinsically beneficial to the United States--to dodge the larger issue of whether they need to make basic changes in defense policy. [REDACTED]

Maintain that trade and defense should be treated as separate issues. The Japanese underline both the importance of treating each problem on its own merits and the danger of permitting disagreements in one area to spill into the other. Nonetheless, the Japanese themselves regard the two as intimately connected. They see defense spending as a drag on the national economy and likely to undermine Japan's trade performance. Moreover, in playing the United States, Tokyo has tried to point to increases in the defense budget to deflect attention from economic differences. [REDACTED]

Cultivate the impression that pressure will probably be ineffective--and that public pressure will be counter-productive. Japanese negotiators often emphasize that the Prime Minister must be responsive to the opinions of other LDP leaders, the party's supporters in agriculture and business, and the public--which prevents him from being as forthcoming as he might wish to be.

-- This argument contains considerable truth, but the domestic political scene is more flexible than the Japanese usually suggest, and Tokyo's foreign policy is as much a product of what the external situation seems to demand as of what the Japanese deem desirable. [REDACTED]

As the political or financial price of concessions increases, however, so will the Prime Minister's need to demonstrate that changes are truly required in order to keep bilateral relations on track. Public statements by high-level US officials tend to be more effective than private messages in influencing key domestic constituencies whose agreement the Prime Minister must obtain to carry out painful policy adjustments. The Japanese argue, however, that such statements could trigger a nationalistic backlash and that, in the context of the subtle norms governing Japanese social interaction, quiet consultations within official channels are more effective.

-- We believe strong public US pressure will indeed carry a price, but it can be reduced if US requests are not total surprises, are explained in reasonable terms, and do not require abrupt departures from Japanese policy. [REDACTED]

Stimulate concern that Japanese concessions could threaten LDP dominance. Tokyo sometimes suggests that giving ground on trade or defense will alienate critical LDP supporters and

endanger the party's control of the Diet, thereby undermining its ability to secure passage of bills of interest to the United States. The possibility of an early election makes this a likely tactic.

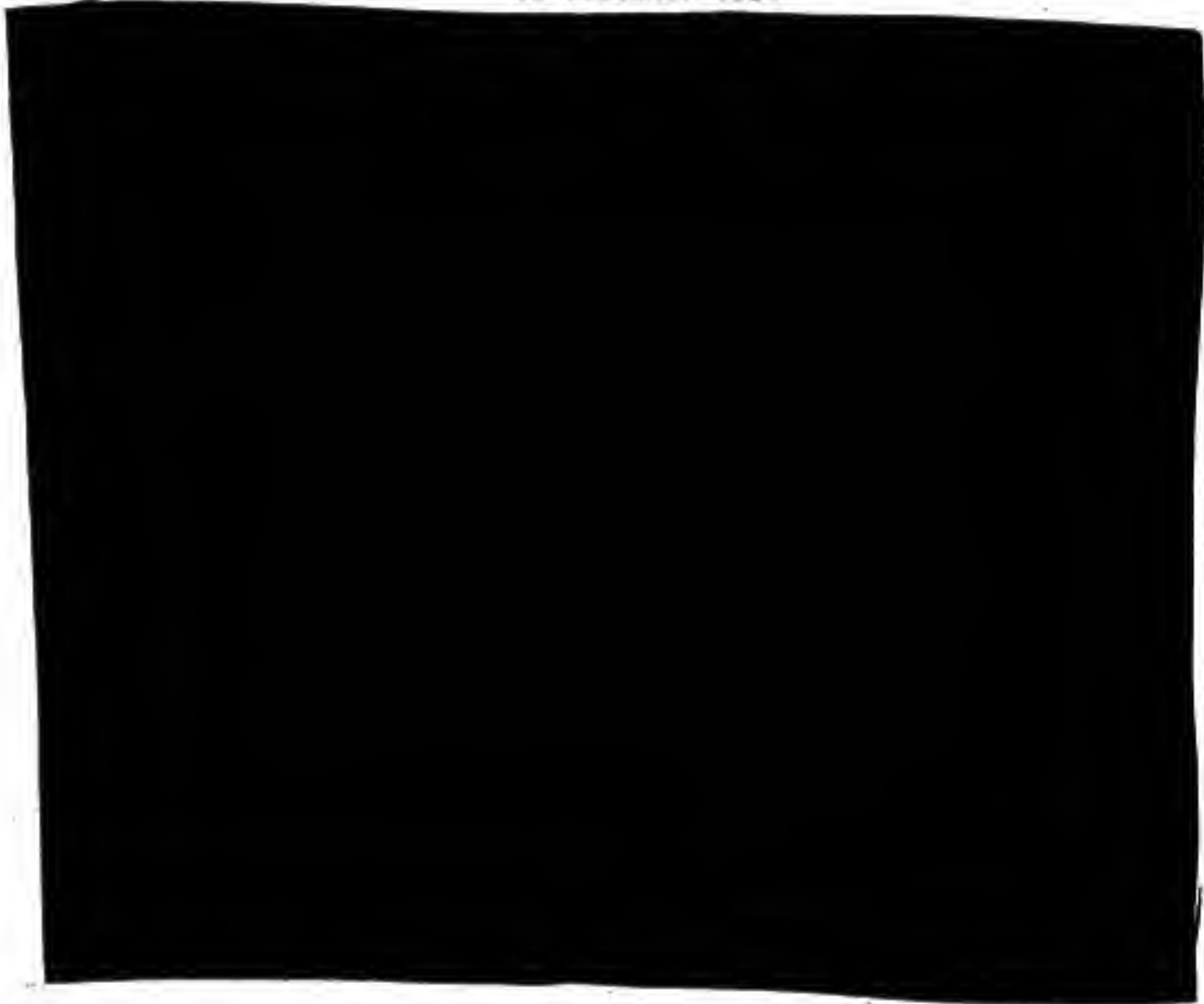
- LDP support is sufficiently tenuous that giving ground on an issue of importance to a key interest group could threaten the party's majority, although this is by no means a foregone conclusion.
- If the LDP lost its majority, management of bilateral relations would indeed become more complicated. Even so, the LDP could ally with one of the moderate opposition parties, which share its view of the importance of the US-Japan relationship. A leftwing government is virtually out of the question. [REDACTED]



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21 December 1984



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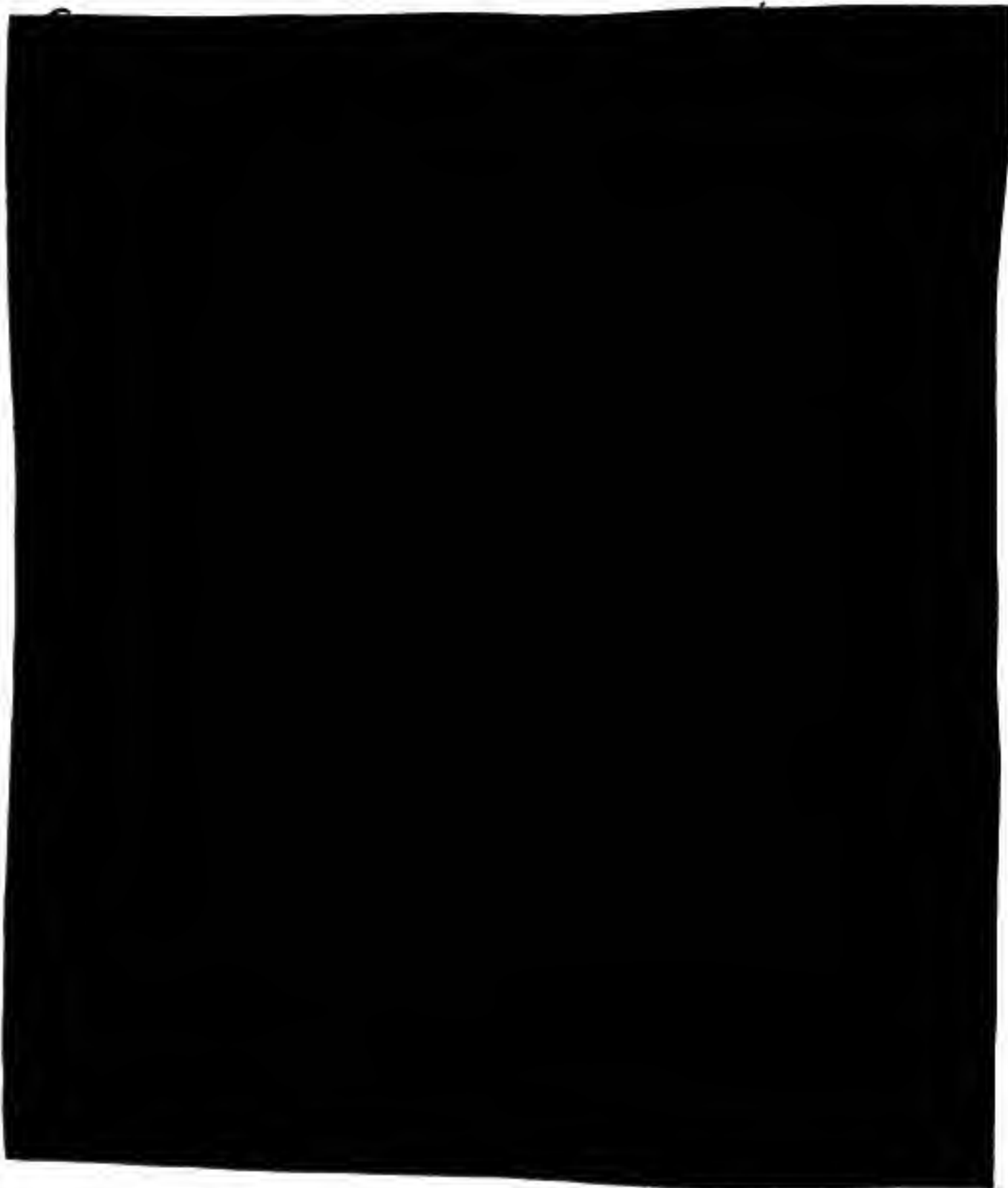
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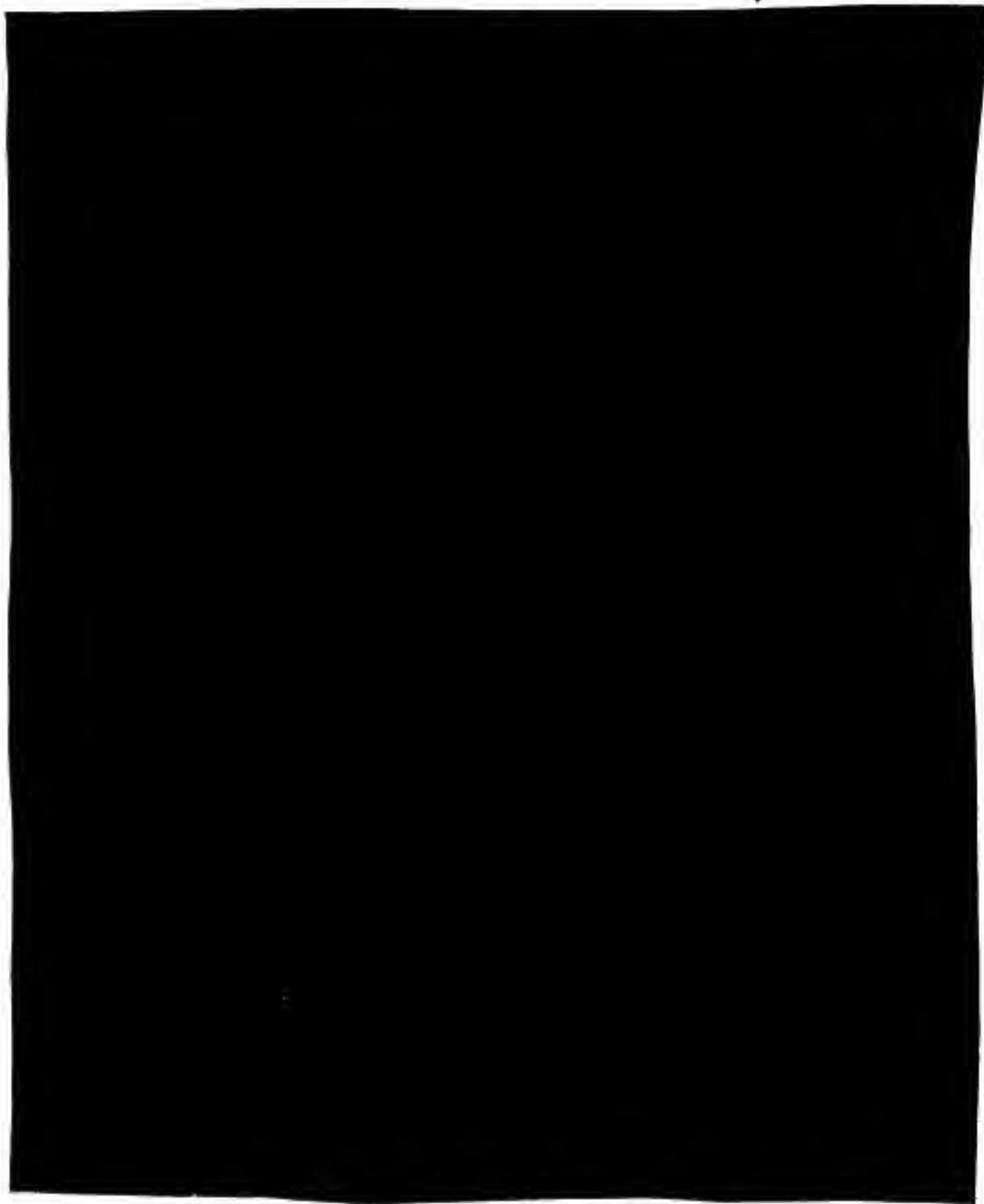
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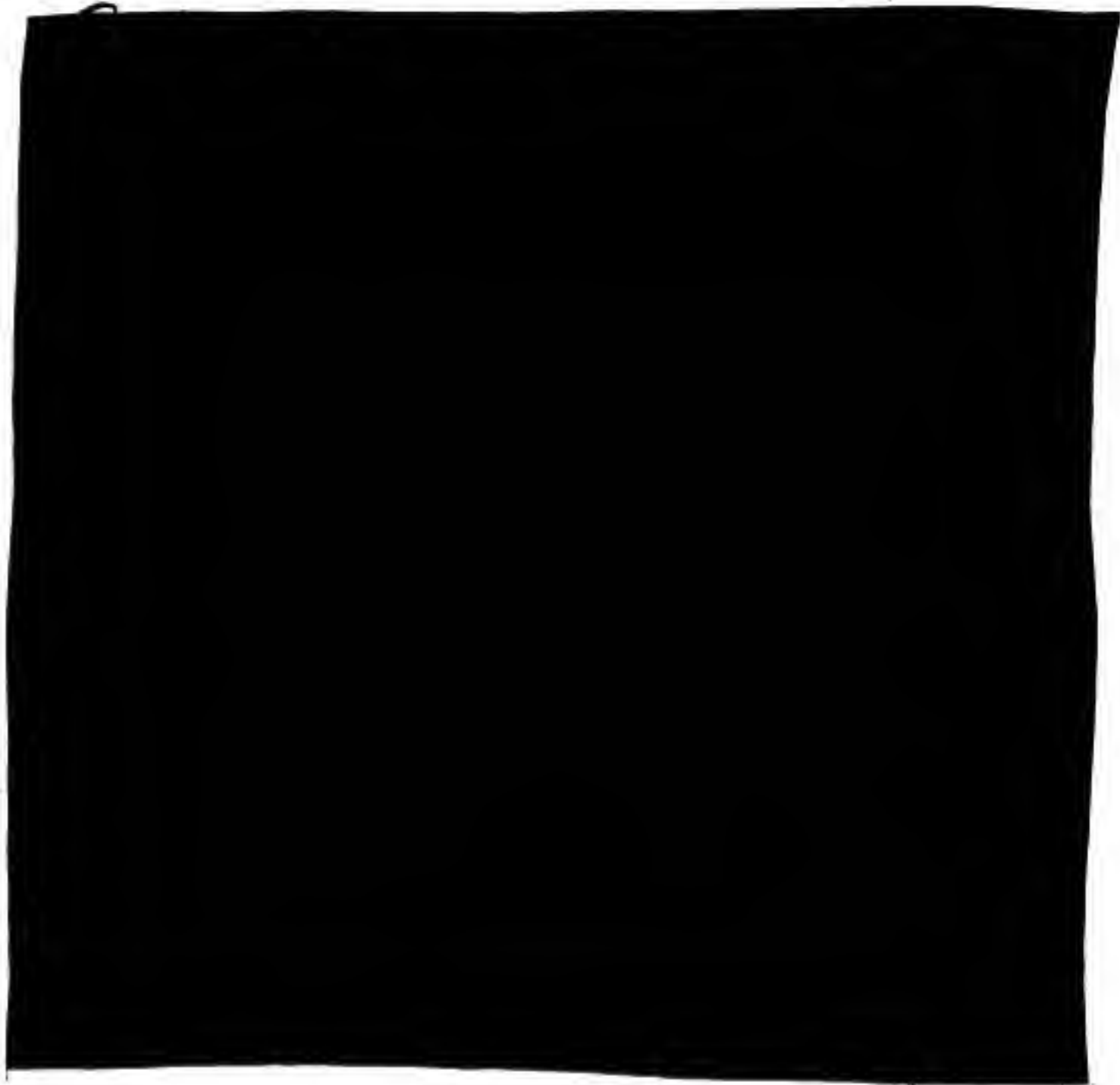
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Objectives of Nakasone's New Administration [REDACTED]

Domestic Goals

Nakasone's primary domestic target during his second administration will be to reduce the government deficit--projected to reach \$11.2 billion in Japan fiscal year 1985--without significantly raising taxes. This priority will govern his approach to other programs. In an effort to fulfill commitments made by previous administrations, his Cabinet will attempt to raise defense and foreign aid spending but will use administrative reform to continue to reduce other government expenditures. [REDACTED]

Pressure is building within the LDP for more expansionary policies--both from Nakasone's rivals who see a weakness they can exploit, and from Diet members who want to stop reductions in pork-barrel projects. For their part, the opposition parties will fight any increase in defense spending, especially if it threatens the 1-percent-of-GNP limit. Although a minority in the Diet, they can stall debate, thus preventing passage of important legislation. [REDACTED]

The bureaucracy, faced with a shrinking pool of funds, will vigorously lobby for key programs. The economic ministries, for example, have tried to sell budget increases by arguing for funding basic research that will aid restructuring toward high technology industries--a national goal. Big business nonetheless opposes budgetary expansion, fearing retreat from administrative

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reform policies could lead to tax increases. Business leaders in general also oppose increased defense spending beyond that necessary to satisfy the United States. [REDACTED]

Security and Foreign Policy Goals

Under the second Nakasone administration, Japan's policy will continue to be dominated by an approach that defines its security primarily in economic terms. Japanese political and government leaders are comfortable with the notion that national security depends on economic success based on trade--which in turn sustains domestic stability under an LDP government. One of Nakasone's primary goals, therefore, is to ensure that the international political and economic environment remains congenial to Japan's foreign trade. To do so he will:

- Seek to sustain world trade and monetary arrangements.
- Endorse projects of interest to the LDCs, such as ASEAN solidarity, the Contadora process, and freedom for Namibia.
- Promote political stability and economic growth in the LDCs through expanded foreign aid and cultivate Japan's image through cultural, sports, and educational exchanges. [REDACTED]

Japan's vulnerability to an interruption in the flow of imported food, fuel, and raw materials is at the top of Tokyo's list of national security concerns. Nakasone's government will, therefore, continue to pursue programs that:

- Maintain domestic production of rice and coal.
- Diversify import sources.
- Reduce import requirements through industrial restructuring and conservation.
- Build stockpiles and maintain foreign exchange reserves.

On the export side, Tokyo's priority objective is to maintain access to markets in North America and Western Europe for Japan's new, high-technology industries. To counter the protectionist threat, Nakasone's government will:

- Promote free trade and emphasize Japan's steps to open its own markets.
- Shift export industries to third countries or offer to build production facilities in markets that might otherwise be closed. [REDACTED]

Military Security Strategy: Most of the LDP and its backers take the Soviet threat seriously and put a high value on the US-Japan alliance, but they essentially believe the US nuclear deterrent solves Japan's security problem as long as the United States maintains military parity with the USSR and the Mutual Security Treaty is in effect. Although the Japanese military establishment has grown in size, sophistication, and public acceptance, it is still intended to perform only limited military functions. From one perspective, Tokyo has put a premium on the political purpose of the Self-Defense Force: that is, as a means to satisfy minimally US demands on defense burden sharing so that bilateral differences do not threaten the Security Treaty itself. [REDACTED]

Aspirations for World Leadership

Nakasone has long believed that Japan should conduct itself with greater independence and self-confidence. Although Japanese generally take pride in his success in elevating Japan's international status, they remain suspicious of schemes that might embroil the country in foreign conflicts and are concerned that Nakasone's known interest in strengthening Japanese defenses could lead to a pursuit of international stature based on military power. [REDACTED]

The Prime Minister's personal ambition to leave his mark on Japanese history and his need to use foreign policy achievements to buttress his somewhat shaky domestic political base coincides with his national pride. Given public sensitivity to his pro-military policy, his attempt to persuade the Japanese electorate that he can keep relations with the USSR on an even keel is particularly important. He has stressed support for US efforts to reopen arms control talks with the Soviets and backs an expanded Japanese dialogue with Moscow. [REDACTED]

[REDACTED] Nakasone hopes someday to persuade the Soviets to resume discussions on the Northern Territories--an unlikely development but a goal that combines his aspirations as a statesman and his nationalism. [REDACTED]

Nakasone also hopes to play the role of mediator in areas of international tension. He apparently believes, for instance, that he may be able to facilitate forward movement on the Korean Peninsula by brokering contacts between Seoul and Beijing and broadening nonofficial Japanese channels to North Korea. Japan will probably also continue to seek a role in mediating the Iran-Iraq conflict. [REDACTED]



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

21 December 1984

Japanese Interest in Disarmament [REDACTED]

Always a favorite Japanese theme, disarmament has recently received heightened rhetorical support from Prime Minister Nakasone and Foreign Minister Abe. Both recognize that Japan's influence is only marginal, but they see clear domestic political and foreign policy advantages in continuing to champion the issue. [REDACTED]

Most postwar Japanese politicians have identified themselves closely with peace-related issues in order to respond to a strong domestic sentiment that Japan must not be drawn into another war.

- Nakasone is particularly sensitive on this score, given his reputation as a hawk as well as press and opposition party accusations that he wants to "remilitarize" Japan and strengthen security ties with the West.
- Pressure on Nakasone is intensified because his foreign minister, who has accorded disarmament a central place in his "creative diplomacy," is a prime contender for leadership of the ruling party.
- Nakasone's position is not complicated by an active peace movement, however, and serious opposition to new US military deployments in Northeast Asia has not yet materialized. [REDACTED]

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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Nakasone has used support for disarmament to legitimize his efforts to strengthen Japan's security.

- Publicizing support for Washington's effort to reopen arms control talks with the Soviet Union helps him distract domestic critics opposed to expanded security cooperation with the United States.
- Nakasone asserted a strong interest in the aborted INF negotiations, pointing to the need for a global agreement that would prevent a Soviet shift of SS-20s eastward, where they could threaten Japan. We believe one objective was to broaden Japanese security horizons beyond the traditional focus on the US alliance to include Western Europe. [REDACTED]

Expressions of support for Western firmness and solidarity in arms control negotiations with the USSR are designed both to shore up relations with the West and to contribute to the overall Western deterrent, which Nakasone is convinced must remain strong throughout any disarmament process. We believe Nakasone hopes the US-Soviet arms control dialogue will show enough progress over the next year to permit a significant thaw in superpower relations. He believes a relaxation of US-Soviet tensions must precede significant improvement in Japan's relations with the USSR, a goal high on his agenda. [REDACTED]



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

21 December 1984

Japan's Relations with the Soviet Union [REDACTED]

Tokyo has taken an increasingly tough stance toward the USSR since the late 1970s, and despite Prime Minister Nakasone's interest in promoting dialogue, Japanese-Soviet relations will probably remain cool.

- Major improvement in political relations depends on Soviet willingness to reopen discussion of the longstanding Northern Territories problems. We believe Nakasone cannot afford to back down on this issue, and Moscow will continue to stonewall because of the islands' strategic significance and concern over the adverse impact territorial concessions might have on future border talks with China.
- The Soviets will probably continue their campaign to foment ill-will between Japan and both its Asian neighbors and the United States. The Japanese are aware of--and resent--Moscow's strategy.
- Moscow shows no sign of moderating its continuing military buildup in East Asia. Many Japanese suspect this is intended in part to intimidate them into conforming to Soviet wishes.
- Moscow's heavy-handed treatment of Japan, combined with the invasion of Afghanistan and the KAL shootdown, has increased popular antipathy toward the USSR, heightened Japanese awareness of the Soviet threat, and contributed to improved domestic political support for the Self-Defense Forces and the US-Japan alliance.

This memorandum was prepared by the Offices of East Asian Analysis and of Soviet Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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- Economic relations are on the decline, partly because political relations have deteriorated but also because large-scale Siberian resource development projects are no longer attractive to Japanese businessmen. [REDACTED]

Nakasone's desire to achieve a "breakthrough" in relations with the Soviet Union stems from an ambition to distinguish himself as the prime minister who persuaded Moscow to agree to discuss the territorial issue. Without such a Soviet reversal, however, his maneuvering room is limited. The Prime Minister and Foreign Minister have said they cannot officially visit the USSR until Gromyko visits Japan, and Gromyko thus far has been unwilling to come as long as Tokyo insists on bringing up the Northern Territories. [REDACTED]

The Soviets probably see in Nakasone's eagerness an opportunity to improve relations. They want to discourage growing US-Japanese collaboration on security issues in Northeast Asia and to forestall US-Japanese-ASEAN cooperation on economic and political matters. Moscow has responded to Nakasone's overtures with efforts to improve the political atmosphere, including the dispatch of high-level delegations, concessions to Japan during the recent fishery negotiations, and suggestions of a possible compromise on preconditions for a Gromyko visit. The Soviets' flexibility on this score will serve as a litmus test of the importance they attach to improved relations during the coming months. Even if Gromyko made the trip, however, we believe prospects for a dramatic breakthrough in political or economic relations would remain poor. Differences on substantive issues run too deep. [REDACTED]

Nakasone nonetheless will continue to encourage expanded private and governmental dialogue with the USSR.

- He wants to demonstrate at home that his commitment to enhancing Japanese security does not entail an unnecessarily provocative anti-Soviet policy.
- He has also stated repeatedly that Tokyo must keep channels of communication open to the Soviet Union precisely because it is Japan's most difficult and dangerous neighbor.
- He shares the prevalent Japanese view that Japan's relations with the Soviet Union are largely dependent on US-Soviet relations and Tokyo should not lag behind if Washington and Moscow improve their relationship. [REDACTED]



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

21 December 1984

Japan and China--Growing Strategic and Economic Ties [REDACTED]

Prime Minister Nakasone's visit to Beijing last March underscored the importance both countries attach to their relationship. Converging economic and strategic interests have encouraged closer ties. Tokyo sees China as a potentially lucrative export market, as well as a significant source of energy and other raw materials. China hopes to acquire increased Japanese investment, financial credit, and technology, as well as a larger Japanese market for Chinese goods.

- Trade is running at record levels this year. Japan has been China's largest trading partner since the mid-1960s, accounting for more than 20 percent of total trade.
- Japan is also China's largest creditor, and Japanese direct investment in China is picking up after a slow start. Japan's Export-Import Bank recently decided to supply \$2.4 billion in low-interest loans to finance Chinese oil and coal development projects.
- China has moved to the top spot among Japan's foreign aid recipients. Prime Minister Nakasone announced a \$2 billion aid package in March.
- Tokyo also has agreed to a one-time export of nuclear reactor equipment, subject to on-site "visits" by Japanese officials. The two countries are negotiating a bilateral nuclear cooperation agreement. [REDACTED]

The growth of Soviet military power in Asia has prompted Tokyo and Beijing to adopt broadly complementary policies toward the USSR and its allies.

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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- During Nakasone's trip, both sides reaffirmed opposition to increased Soviet deployment of SS-20s in Asia and agreed to share information on the missiles.
- Both governments have opposed the Vietnamese occupation of Kampuchea and have provided strong diplomatic backing for ASEAN's efforts to bring about a Vietnamese withdrawal.
- Japan and China have condemned the Soviet invasion of Afghanistan, have refused to recognize the Kabul regime, and have sought to bolster Pakistan.
- Although Japan and China support different Korean regimes, both have tried to exercise a moderating influence on their respective partners. [REDACTED]

There is potential for discord in the Japan-China relationship as well as in the Sino-US-Japan triangle. Some in Tokyo are concerned that a radical leadership could reemerge in Beijing, while the Chinese remain wary of Japan's ties to Taiwan. The Chinese will also monitor Japanese response to US pressure to improve its defense capabilities, and both Beijing and Tokyo will compete for the attention of US policymakers. US-Japanese competition in the growing Chinese market for high-technology products could also cause friction in the Japan-China relationship. [REDACTED]

Japanese officials nonetheless are generally optimistic about future bilateral relations. They view support for China's modernization as a way to improve prospects for the survival of a moderate leadership in Beijing, help to reinforce China's "opening to the West," and reduce incentives for a Sino-Soviet rapprochement. The mutual strategic and economic benefits of the relationship probably will encourage continued close ties. [REDACTED]



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

21 December 1984

Japan and the Two Koreas [REDACTED]

Tokyo has always given priority to South Korea over the North, but until a few years ago its tilt was circumscribed by often strained relations with Seoul and a recurring interest in improving ties with P'yongyang. Under Prime Minister Nakasone, Tokyo has shifted decisively toward strong, open support for the South. [REDACTED]

Immediately after his election as prime minister, Nakasone broke the bureaucratic logjam that had blocked conclusion of an aid agreement and engineered a summit with President Chun in Seoul in January 1983. Chun reciprocated in September 1984, and the unprecedented exchange has helped ameliorate longstanding tensions and establish a political framework for progress on substantive issues. Even so, differences over the transfer of Japanese technology, South Korea's continuing trade deficit with Japan, and historic ethnic antagonisms typified by the treatment of Koreans living in Japan are certain to strain relations. [REDACTED]

Accompanying Nakasone's determination to strengthen relations with the South is willingness to support Seoul on critical issues related to the North.

- The Prime Minister expressed an unusual degree of personal sympathy after both the KAL shootdown and the assassination attempt in Rangoon.
- After Rangoon he also imposed sanctions on North Korea for more than one year, and he has supported Seoul's position on the inter-Korean dialogue.

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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The domestic political liabilities in taking a firm line toward North Korea have declined in recent years. All opposition parties have distanced themselves from the North, and the non-Communist opposition has moved to improve relations with the South. The LDP, therefore, is under less pressure to appear interested in adopting a "balanced" Korea policy. [REDACTED]

Nonetheless, Tokyo still sees advantages in broadening nonofficial contacts with North Korea. Aside from the economic benefits of regularizing fishery arrangements, encouraging some progress on repayment of North Korean debts, and expanding trade, Japanese officials believe P'yongyang should be drawn out of its isolation and into closer contact with the West. In addition, we believe Nakasone wants to work toward legitimizing the division of the peninsula by encouraging contacts among the two Koreas and the major powers and sees Japanese dialogue with the North in this context. Although the Prime Minister probably harbors few illusions about P'yongyang's objectives, he seems to see an opening for some forward movement. He has:

- Joined the United States in urging China to increase contacts with South Korea and has offered Japan's good offices as an intermediary.
- Applauded the North's offer of flood relief and its willingness to resume talks with the South.
- Endorsed Seoul's request that both Koreas be admitted to the United Nations.

Nakasone hopes to be in a position to act quickly should these limited signs of movement develop into an inter-Korean thaw. He wants to take as much credit as possible for any progress achieved and is sensitive to the negative political fallout in the event others--especially the United States and China--negotiate an understanding without Japan's knowledge. [REDACTED]



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

21 December 1984

Pacific Basin Economic Cooperation [REDACTED]

Pacific Basin economic cooperation, a recurring theme in Japanese policy for over a decade, will be high on Nakasone's agenda in California. [REDACTED]

- In addition to shifting the spotlight from bilateral trade friction, the Pacific cooperation idea gives Nakasone a region-wide issue on which he can work with Washington as an equal and thereby enhance his leadership image at home.
- Nakasone probably sees sponsorship of Pacific cooperation as a way to win support among LDCs for his plans for a new multilateral trade round.
- He may also hope that even limited success of a cooperation plan would help Japan by smoothing relations with suppliers of important commodities. Economic expansion in the Pacific would also create new export opportunities for the United States--perhaps reducing the focus on the bilateral trade relationship. [REDACTED]

Nakasone probably will address Pacific Basin cooperation in broad terms, but may also suggest several relatively small cooperative projects. Tokyo wants to keep the US and Japanese presence in the plan low key to avoid putting off the smaller countries and reviving memories of Japan's wartime East Asia Co-Prosperty Sphere. By keeping the projects small, Tokyo can also keep the cost down. [REDACTED]

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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The projects will be practical and concrete to respond to LOC and NIC complaints that such plans are too often merely hot air.

- Nakasone probably will again raise the idea of a joint fund for Pacific Basin academic studies.
- Tokyo advocates splitting human resource development responsibilities, with Japan giving low technology training on Okinawa and the United States providing high-tech education in Hawaii.
- Nakasone believes the private sector should sponsor the initial stages of cooperation. [REDACTED]

Debates over which nations should be included and differences among Southeast Asians who would not benefit equally from the projects could easily derail the plan.

- The ASEAN nations will probably balk if China and South Korea are included. They fear Tokyo and Washington might ignore Southeast Asian interests in favor of catering to these more important powers. China's inclusion if Taiwan were excluded could also create difficulties. [REDACTED]



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

21 December 1984

Japan's New Initiatives in Africa [REDACTED]

After years of essentially ignoring Africa, Tokyo has begun to focus on the continent.

- In mid-November Foreign Minister Abe became the first senior Western minister to visit drought-stricken Ethiopia and Zambia. During the trip he announced that Tokyo would increase food aid to Africa by nearly \$50 million, bringing the total to \$163 million for JFY 1984.
- During the same period, a joint government-private sector mission--reportedly the largest Japanese delegation ever dispatched to the continent--visited eight African countries to investigate how Japan could best provide financial and material assistance. Stops included Ethiopia, Zambia, and Mozambique.
- As a result of Abe's briefings upon his return home, Tokyo plans to step up activity in Africa, urge other industrialized nations to provide greater support, and seek closer US-Japanese cooperation in the region. Japanese aid to Africa totaled some \$265 million in 1983.
- At the request of African leaders, Japan has agreed to act as UN coordinator on African issues.
- In an effort to stimulate the limited domestic interest in Africa, the Japanese Government is conducting a publicity campaign, which has included naming October "Africa month" and holding "starvation lunches." [REDACTED]

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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Although Tokyo's sudden interest in expanding its role in Africa is motivated in part by humanitarianism, both the Foreign Minister and the bureaucracy have seized on African issues for more important reasons.

- With international attention focused on drought and famine victims in the region, Tokyo views it as an arena in which to demonstrate to Washington and other Western nations that Japan is a cooperative ally ready to fulfill its international responsibilities.
- Abe's political ambitions almost certainly were a driving force behind his trip. Abe, who wants to succeed Prime Minister Nakasone, hopes to gain public recognition of his "creative diplomacy"--without sharing the credit. Abe's earlier solo venture in Middle East diplomacy, where his efforts to mediate the Iran-Iraq war have stalled, has not served that goal well.
- Japanese officials have also said they want to prevent growing economic problems in Africa from becoming a destabilizing force and a drain on the international community.
- These factors suggest Tokyo's interest in Africa could decline if the involvement of other industrialized nations falls off or if Abe identifies other areas that better serve his political interests. [REDACTED]

We believe the emergence of a more active Japanese role in Africa, especially if Japan shares the economic burden of assisting the poorest nations, will generally serve US interests.¹ The Japanese may go further than the the United States wants, however, by giving more than humanitarian aid to such Marxist countries as Ethiopia. Tokyo wants to keep its political foot in the door and claims to be more optimistic than Washington about the prospects for Ethiopia's turning to the West. [REDACTED]

Japan also has a large stake in South Africa. Tokyo does not have full diplomatic relations with Pretoria and in international forums is careful to denounce consistently apartheid policies. But Japan maintains strong commercial ties to South Africa. Trade amounts to more than \$2 billion per year, accounting for about half of Japan's total trade with the African continent. We believe relations with Pretoria will continue under the current arrangements as long as business remains attractive. [REDACTED]

¹ Japanese aid to Africa totaled some \$265 million in 1983. [REDACTED]



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

21 December 1984

Financial Liberalization [REDACTED]

Prime Minister Nakasone considers the yen/dollar accord reached by US and Japanese finance officials last May as one of the high marks of bilateral relations in 1984. He has been quick to echo Western praise of Japanese financial market liberalization, which the accord promotes. Nakasone has been almost as sensitive to US Treasury criticism of the way Tokyo is implementing some of the agreed-upon measures.

- [REDACTED] the Prime Minister shares US concerns about the limited liberalization the Finance Ministry is advocating in certain areas.
- In particular, Nakasone has questioned Ministry decisions to exclude securities firms from the soon-to-be created yen bankers acceptance market and to require banks to notify the Ministry before issuing Euroyen certificates of deposit. [REDACTED]

We believe prospects for resolving bilateral differences over implementation are generally good. In response to Nakasone's criticisms, Finance Ministry officials have [REDACTED] said they will phase out most of the restrictions that upset their US counterparts. The officials have not disclosed when the restrictions will be lifted, but continued prodding by Nakasone should ensure genuine liberalization in these areas.

On the other hand, bilateral differences over trust banking activity by foreigners will probably fester. Tokyo plans to carry through on its yen/dollar accord pledge to allow foreign

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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[REDACTED]

banks to undertake trust banking in Japan beginning in 1985, but the Ministry of Finance intends to license only eight foreign institutions--the number of Japanese banks engaged in such activity.

[REDACTED]

We believe financial liberalization outside the confines of the yen/dollar accord will accelerate through the remainder of the decade despite bureaucratic obstacles. Continuing the pattern of the past ten years, the maturing of the Japanese economy will provide the primary impetus for deregulation.

- The economy's post-1973 transition from a high-growth to a medium-growth path destroyed much of the rationale for a tightly regulated financial system. The Finance Ministry responded with narrowly focused and piecemeal reforms, but once begun, liberalization fed upon itself. Losers from past deregulation demanded--and continue to demand--compensation in the form of liberalization in an area of their choice. Furthermore, the expanded freedom given Japanese banks in international dealings is generating pressure for similar leeway at home.
 - In an effort to ease the nation's transition to slower economic growth, Tokyo floated massive amounts of government debt starting in 1975. Issued with ten-year maturities, this debt begins maturing in the coming Japanese fiscal year (April 1985-March 1986). To refinance these bonds smoothly, the government must introduce new flexibility into funding methods and terms of new issues. Such reform will have ripple effects throughout the financial system, as regulators tend to link key interest rates to government bond yields.
 - In the mid-1970s when growth prospects dimmed, Japanese manufacturers took a keener interest in international markets. This contributed to the mushrooming of the current account surplus, which approached \$35 billion in 1984. As the surplus increased, so did fears about regulations inhibiting the efficient recycling of funds overseas. In response, Tokyo has improved foreign access to yen markets for sovereign borrowers. As long as savings remain above domestic needs, we believe the Japanese Government will feel compelled to liberalize further the country's international financial dealings.
- [REDACTED]



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

21 December 1984

Status of Software Protection Legislation [REDACTED]

Legislation proposed by the Ministry of International Trade and Industry (MITI) to remove software from copyright protection could limit exports to Japan by US firms in the service, computer and software fields. The Ministry wants to promote the domestic software industry--an essential ingredient in economic restructuring--and to aid mainframe computer manufacturers by improving their access to US systems software, long the industry standard. MITI's plan would reduce the period of protection from 50 to 15 years and include provisions that could mandate release of software to competitors. If this occurs:

- US companies would be reluctant to sell software-based services or products in Japan, fearing the release of the software, which is frequently the most valuable component.
- Other nations, especially the NICs and LDCs, might follow the Japanese example, cutting further into US high-technology trade. [REDACTED]

The Trade Ministry would like to see the law pass this spring, although US pressure and a turf battle between MITI and the Education Ministry, which controls copyrights, have put it on the shelf for now.

- The Education Ministry is engaged in disputes with MITI on several other fronts and is not likely to give in on copyrights.
- The Foreign Ministry also opposes the MITI position.

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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[REDACTED]

We believe continued pressure from the United States and Europe, combined with the bureaucratic deadlock, could push the issue to a political level in the ruling party for final arbitration. Because MITI's plan is so unambiguously protectionist, the leaders of the ruling party could well respond positively to pressure from Washington on software. [REDACTED]



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

21 December 1984

Liberalization of Japan's Telecommunications Market [REDACTED]

US access to Japan's multibillion dollar telecommunications market will depend on the evolution of the market after Nippon Telegraph and Telephone (NTT) returns to the private sector in April. Several barriers to a completely open market are possible, the most serious stemming from the Telecommunications Ministry's (MPT) attempts to retain control of its traditional turf.

- MPT is drafting ordinances governing the approval of technical standards for telecommunications equipment that are apparently more restrictive than the current regulations.
- The Ministry has formed an association of Japan's largest equipment manufacturers to determine standards; foreigners will not be allowed to attend meetings of this body.
- The notification system for the establishment of telecommunications service companies could be used to restrict foreign firms. [REDACTED]

NTT's efforts to expand its markets also could limit US entry.

- [REDACTED] NTT may continue to release technology to suppliers on a preferred basis.

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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[REDACTED]

Nonetheless, forces within Japan could encourage a more open market. With budget growth virtually frozen except for defense and foreign aid, the economic ministries are attempting to move into new areas in order to compete for a share of the shrinking pie.

- MITI, the Construction Ministry, and the Transportation Ministry, which all are trying to expand their influence into telecommunications, will oppose MPT's attempt to dominate the sector, as will NTT. [REDACTED]

The prospect of liberalization also has energized foreign and domestic firms that wish to enter the market. Forced to survive in a competitive environment, NTT will have to base its procurement and technology sales more on profit/loss considerations than on concern for maintaining traditional relationships. Although it is likely to dominate the overall market, it probably will have to purchase equipment, software and databases abroad, improving prospects for US firms, which have a competitive edge in telecommunications services. [REDACTED]

US pressure has helped to accelerate the liberalization process and probably can continue to influence the development of a truly open market.

- Because telecommunications is a relatively new issue, interest groups are not firmly established and do not have the political clout of traditional lobbys such as agriculture.
- MPT is not experienced in the international arena and probably is susceptible to high-level pressure.
- Japanese businesses wishing to break into the telecommunications market share the US desire for an open market.
- The impasse created by bureaucratic rivalries could kick decisions up to the Liberal Democratic Party, which may be more inclined to make political choices that reflect Washington's interests. [REDACTED]



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

21 December 1984

The Defense Spending Limit [REDACTED]

Over the past several months politicians, bureaucrats, special study groups, and the press have begun to focus on the question of whether Japan's defense spending will--and should--break the self-imposed limit of 1 percent of GNP set in 1976. Spending on defense is expected to total .998 percent of GNP when the fiscal year ends on 31 March.

- Last spring Prime Minister Nakasone appointed a Liberal Democratic Party (LDP) study group to consider revising the ceiling.
- During the summer some politicians and members of the press predicted that a proposed pay hike for government employees or the Japan Defense Agency's request for a 7-percent increase in its JFY 1985 budget could push spending over the limit.
- Defense advocates in the LDP recommended this fall that the ceiling be revised, pointing to US pressure for Japan to do more in its own defense.
- The Peace Research Council--a private think tank commissioned by the Prime Minister to study defense issues--recommended in mid-December that the ceiling be abolished.
- In mid-December the defense caucus of the LDP is expected to recommend revising the ceiling.

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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- Although the Democratic Socialist Party also supports breaking the limit, the other opposition parties-- including the LDP's small coalition partner--are opposed, arguing it would violate Japan's postwar peace orientation. [REDACTED]

Proposals for a new limit have included changing the cap from "below 1 percent" to "about 1 percent," leaving the limit at 1 percent of GNP but removing defense personnel costs, raising the ceiling to between 1.3 and 2 percent, or eliminating it altogether. [REDACTED]

[REDACTED] that Nakasone might announce a change in the ceiling in December when the budget is approved by the Cabinet, but at present the timing does not appear right for such a move.

- Japan's rate of economic growth will allow Tokyo to sustain the present rate of defense spending growth without breaking the limit.
- Embassy reporting suggests Nakasone does not now have broad support within the LDP for announcing a revision of the ceiling.
- Breaching the limit in December could work to Nakasone's advantage in talks with the President, but could also open the way for domestic criticism that he did so to follow Washington's dictates. [REDACTED]

Japan will probably break the barrier sometime in 1985, especially if growth is lower than anticipated or a supplemental budget is passed. Many in the LDP would prefer the break to occur during the summer when the Diet is not in session. That timing would also allow for extensive groundwork as a result of debate on the issue in the spring budget hearings and the recommendations by authoritative defense study groups. [REDACTED]



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

21 December 1984

Japanese Defense Procurement [REDACTED]

This spring Tokyo was forced to acknowledge it would not reach the procurement objectives of the National Defense Program Outline (NDPO), Japan's basic military planning document, by the end of the current Midterm Operations Estimate (MTOE) in 1987.

- Funding problems caused by the 1 percent of GNP cap on defense spending forced repeated delays in orders of weapons systems included in the plan.
 - Postponing achievement of the NDPO has pushed back any possibility of completing the already outdated Outline--drafted in 1976--until the mid-1990s at the earliest.
- [REDACTED]

The first objective of the next MTOE, covering Japan fiscal years 1986-90, therefore, will be to make up the procurement shortfalls in the previous plan. That will only be possible if the Japan Defense Agency's (JDA) budget is significantly and consistently increased through 1990--and the Japanese record to date makes that unlikely. [REDACTED]

Planning now under way on the new MTOE reflects more balanced procurement, incorporating improvements in the logistics base with weapons purchases. The Estimate emphasizes improving sealane and air defense capabilities.

- The Maritime Self-Defense Force will seek to increase the number of P-3C antisubmarine reconnaissance aircraft, outfit destroyers with close-in air defense systems against missiles, and equip submarines with surface-to-surface missiles.

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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- Air Self-Defense Forces improvements will concentrate on developing the next generation of fighters, improving the air defense warning and control system, introducing the US Patriot surface-to-air missile system to replace the aging Nike-J, and possibly developing an aerial refueling capability for its fighters.
- The Ground Self-Defense Force will seek to introduce new tanks and improved infantry combat vehicles to be fielded primarily in Hokkaido. [REDACTED]

Some high-level officials in the Defense Agency and the Liberal Democratic Party (LDP) have called for a revision of the goals under the NDPO. They point out that the original Outline was written during a period of detente between the United States and the Soviet Union. They cite the build-up of Soviet SS-20s in Asia, the KAL incident, and changes in force levels in Korea as reasons why Japan should not restrict itself to the original framework of the NDPO. The LDP, in fact, is considering revising both the 1-percent defense spending cap and the NDPO. The party's success with the spending limit will indicate the likelihood of real changes in the NDPO. [REDACTED]



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DIRECTORATE OF INTELLIGENCE

21 December 1984

Defense Technology Transfer [REDACTED]

Despite exchanges of messages and some bilateral discussions, defense technology transfer generally remains stymied, with little evident progress since the November 1983 agreement with Washington. A specific US case has not yet been proposed to test the accord, and the Ministry of Foreign Affairs, the Japan Defense Agency (JDA), and the Ministry of International Trade and Industry (MITI) still do not agree on how to handle a test when it occurs. [REDACTED]

Even so, some groundwork has been laid:

- In August, Washington formally identified five general technologies for possible exchange with the Japanese.
- In November, the Joint Military Technology Commission, established under the agreement to expedite technology exchanges, met for the first time. [REDACTED]

Japanese business continues to have reservations about the exchange agreement.

- The private sector is skeptical of US motives and worried that officials negotiating for access to Japanese technologies could compromise proprietary information and make it available to potential US competitors.
- Business also believes Washington uses US national security concerns as an excuse for deliberately limiting Japanese access to US commercial technologies and, therefore, sees little reason to be forthcoming.

This memorandum was prepared by the Office of East Asian Analysis in support of President Reagan's meeting with Prime Minister Nakasone on 2 January 1985. [REDACTED]

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[REDACTED]

[REDACTED]

Even so, there is little evidence that the Japanese bureaucracy itself wants to move ahead in implementing the accord. So far, no ministry has taken the initiative to push for implementation and none appears likely to do so until firm US proposals for technology exchange force Tokyo's hand. [REDACTED]



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21 December 1984

Controlling Technology Loss [REDACTED]

In an effort to keep step with the Western crackdown on technology losses to the Soviet Union and its allies, Japan has strengthened and redesigned its export control program. The most striking development over the past two years has been an increase in the level of coordination among the ministries charged with formulating, implementing, and enforcing export controls. The new program has spurred both cooperative and complementary efforts, including:

- Formation of an interagency committee with representatives from the Trade and Foreign Affairs Ministries, the National Police, Customs, and the Japan Defense Agency to improve Japanese export controls.
- More careful review of entry visas for East Bloc trade and scientific delegations, as well as stricter interpretation of export control regulations.
- Initiation of end-user certificates and some controls on reexports.
- Awareness programs designed to enlist public support and business compliance with the stricter controls. [REDACTED]

Most of Tokyo's measures informally extend existing authorities that limit Soviet access to advanced technologies and discourage unwanted transfers before they occur. Consequently, the results are not as visible as the seizure of proscribed cargoes and prosecution of violators carried out in other COCOM countries. Nonetheless, by avoiding formal legislation Tokyo has

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EA M 84-10242
[REDACTED]

maintained flexibility to discourage or delay technology sales while exercising its near autonomous control over export licenses. [REDACTED]

Most major trading and manufacturing firms--believing they have little to lose because of the poor political and business relations between Japan and the USSR--have accepted Tokyo's stricter controls.

-- Many have denied Soviet requests for restricted technologies.

-- Others with histories of illegal sales now insist that proper export licensing procedures be followed. [REDACTED]

Largely as a result of continuing US and international pressures, as well as its own experiences with Soviet espionage activities, Japan has become sensitive to the strategic implications of unregulated technology transfer and more aware of Japanese vulnerability to Soviet S&T collection. With the exception of antiespionage legislation, however; proposals for new laws restricting trade or the activities of foreigners in Japan are unlikely. Nonetheless, improvements made thus far probably will become permanent, with further refinements coming at a measured pace, as long as the Western consensus on controlling technology leakage holds. [REDACTED]



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21 December 1984

Economic Growth and Budget Issues [REDACTED]

Prime Minister Nakasone will face some difficulties next year in his effort to manage the growth-oriented Japanese economy:

- The recent 5-percent growth rate is a big improvement over the previous four years' lackluster performance, but it has been driven partly by strong export performance. With the foreign sector weakening, GNP growth in 1985 will probably slow. Our most recent figures show weakened foreign demand cutting overall growth in the third quarter of 1984 to an annual rate of 3 percent.
- Growth of the domestic economy has picked up this year, but some in Tokyo are concerned that investment will drop next year as the foreign sector's stimulus declines.
- Meanwhile, Nakasone's rivals within the Liberal Democratic Party (LDP) have used proposals for boosting economic growth to question his management of the economy. Kiichi Miyazawa, heir apparent of the Suzuki faction, and former Economic Planning Agency Director General Komoto have both called for fiscal stimulus-- either through increased public spending or tax cuts.

The government's commitment to holding the line on spending in an effort to reduce the government's persistent budget deficit will constrain steps to strengthen domestic demand. The LDP's supporters in the business and financial world also favor controls on spending and a smaller government sector, as does the

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EA M 84-10243
[REDACTED]

powerful Ministry of Finance. The Finance Ministry has proposed a tight budget for JFY 1985 that will cut most agencies' spending by 10 percent.

- Defense and foreign aid are major exceptions. These items, along with rising debt service costs, will drive overall spending up by 4 percent. [REDACTED]

**JAPAN: THE NAKASONE ADMINISTRATION'S HANDLING OF
ECONOMIC ISSUES OF CONCERN TO THE UNITED STATES**

<u>Issue</u>	<u>Status</u>	<u>Comments</u>
1. Financial liberalization		Much progress made in implementing 1984 yen/dollar accord, which promotes deregulation. Differences over trust banking and Euroyen markets remain.
2. Agricultural quotas and tariffs		Agreement reached in spring 1984 calls for expansion of beef and citrus imports over next three years. Government refuses, however, to consider complete liberalization of agricultural imports.
3. Standards and certification procedures		Recently have begun to accept foreign test data but implementation in several key areas still slow.
4. Telecommunications legislation		Foreigners will be allowed to sell value-added networks after Nippon Telegraph and Telephone (NTT) privatized in April 1985. New equipment standards being drafted appears they may be more restrictive than before.
5. NTT procurement of foreign equipment		After bilateral agreement took effect in 1981 foreign sales to NTT increased initially, but US sales have declined recently. Outlook uncertain after return of NTT to private sector.
6. Restraint on steel shipments to the United States		Have expressed willingness to accept export restraints although have yet to agree on limits for various types of steel.

- Indicates issue basically resolved during Nakasone's tenure.
- Indicates progress has been made but problem areas remain.
- Indicates no real movement has occurred since Nakasone took office in 1982.

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EA M 84-10244

ISSUE	STATUS	COMMENTS
7. Voluntary restraint on export of cars to the United States	●	Decided to extend initial agreement signed 1980 for a fourth year. Bureaucrats have hinted extension in 1985 also possible.
8. Purchase of foreign satellites		Tokyo will allow private firms to purchase foreign satellites, but government policy of domestic development of satellites remains firm.
9. Permission for foreign lawyers to practice in Japan	●	No movement so far and none likely before 1987.
10. Whaling moratorium		Tokyo signed agreement in November 1984 to stop sperm whaling as of 1988, but disagreements with Washington over interpretation have subsequently arisen.
11. Software legislation		Proposed protectionist legislation stalled by bureaucratic wrangling but not yet dead.
12. Sales of foreign cigarettes		Japan Salt and Tobacco Company monopoly on sales ended, but concerns about distribution and pricing system persist.
13. Energy purchases from United States	●	Participating in feasibility study of Alaska LNG project but dragging feet on boosting coal purchases.
14. Removal of semiconductor tariffs	●	Elimination of tariffs approved by Tokyo and will be enacted when parallel legislation passed by US Congress.
15. Foreign direct investment in Japan	●	In May 1984 Diet revoked regulations limiting foreign investment in 12 Japanese companies. Improvements also made in approval process for direct investments.
16. Depressed industry policy	●	Still limits foreigners' sales opportunities by aiding noncompetitive industries. Continues to restrict foreign access to industrial trade councils.
17. Excise taxes	●	Expanding number of items subject to excise taxes, which hit import sales


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EA N 84-10244

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Pages: 9 pages


Exemptions: (b)(1), (b)(3)





Intelligence Report


6 May 1996

Japan: Watching US Supercomputer Procurement Closely


Japan's NEC Corporation is positioned to win its first-ever sale to a US Government facility. NEC recently won the performance test at the National Center for Atmospheric Research (NCAR), beating out one US and another Japanese vendor, according to NCAR officials. 

Japanese Government and industry consider this sale a test of the openness of the US market to Japanese supercomputers. 



- In the six years since the agreement went into effect, US vendors' share of the Japanese public sector market has grown from less than 10 percent to over 30 percent. 

Many industry experts assess the performance of the most advanced NEC supercomputers as roughly comparable with that of leading US systems.

- The NEC supercomputer outperformed other competitors at NCAR because its architecture is well matched to NCAR's requirements for long-term weather modeling computations. 



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Nonetheless, NEC has had some problems with recent sales.

[REDACTED]

[REDACTED]

NEC is offering its system at a price well below US counterparts.

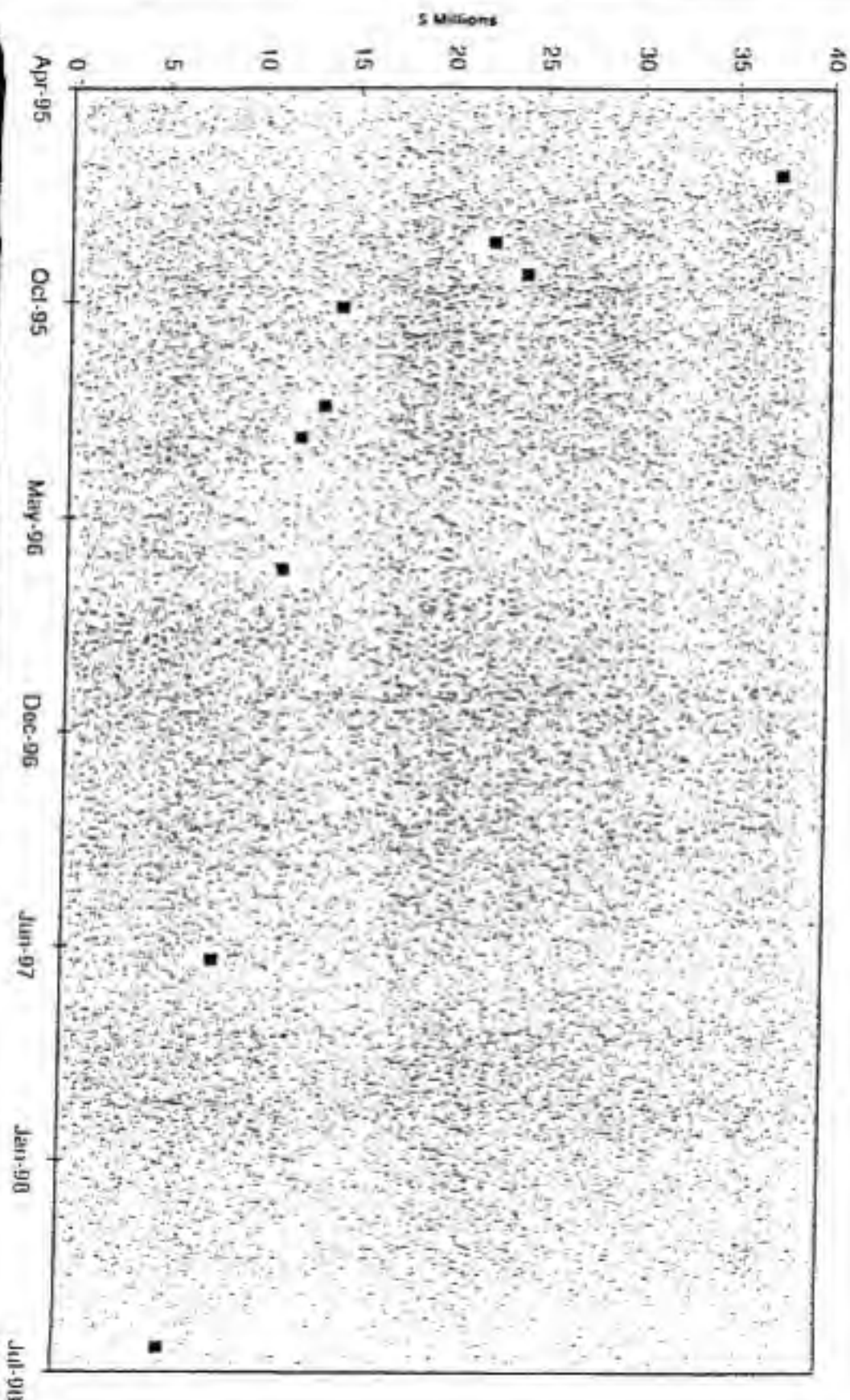
- It is unclear, however, if NEC is selling the system below cost. NEC is a large, vertically integrated firm with world-class, in-house, semiconductor production capabilities; this provides the firm with a significant advantage over its US competitor.
- NEC plans aggressive price cuts over at least the next three years (see attached graphic). [REDACTED]

An NEC win at a prestigious US Government facility would improve the vendor's prospects for additional US sales.

- According to recent US Government study, NEC accounts for less than one percent of the supercomputers operating in the United States.
- Some industry experts believe that NEC will benefit from working with the expert supercomputer users at NCAR. Most supercomputer makers rely on their most advanced users to define next generation hardware and software. [REDACTED]

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NEC Supercomputer Pricing Schedule



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USSR-JAPAN: Increased Acrimony

Relations between the USSR and Japan have deteriorated markedly. Conflicting security policies pursued more vigorously by new leaders in Tokyo and Moscow are the heart of the problem. Both sides have reason to take some of the current heat out of the relationship, and public manifestations of the problem may subside in the near term. Even so, the abrasiveness that has characterized relations since the invasion of Afghanistan and the likelihood that the new leaders will not make major substantive concessions strongly suggest that the impasse will persist for the foreseeable future.

[REDACTED]

[REDACTED]

Soviet Threats

Moscow attacked the new emphasis on defense as a revival of "militarism." It reacted to the "aircraft carrier" remark by denouncing Nakasone by name and by indicating that Japan could become a target for nuclear attack.

[REDACTED]

While Nakasone was in Washington, the USSR made public its earlier INF proposal to move some SS-20 missiles to Siberia--out of range of Western Europe but within range of Japan. The Soviets have since told Japanese officials that SS-20s in East Asia are not directed at Japan but are defensive weapons made necessary by US bases in South Korea and Japan.

[REDACTED]

--continued

The threat to transfer SS-20s from Europe, however, has made both the Japanese Government and public more aware of the INF issue. The Japanese have asked for close consultation with the US on the INF talks and are increasingly interested in a dialogue with NATO. [REDACTED]

Tokyo believes the Soviet campaign is designed to intimidate Japan, foment discord in US-Japanese relations, and stimulate popular and business pressure against the Prime Minister. Public opinion polls indicate many Japanese are worried by Nakasone's tough stand on defense, but there has been nearly universal resentment of Moscow's heavyhanded threats. These threats have reinforced Nakasone's firm approach to relations with the USSR, and he has made clear that he will not be bullied. [REDACTED]

The tough Soviet rhetoric also is aimed at arousing fear of Japanese militarism in other Asian countries, particularly China. In addition to preventing the establishment of a formal security relationship among China, Japan, and the US, the USSR is trying to undermine current understandings among the three powers on security issues. [REDACTED]

The Soviet effort to drive a wedge between the Japanese and Chinese has not been particularly effective. Last month Nakasone sent an emissary to Beijing to reaffirm good relations and discuss Japan's diplomatic and defense posture. The visit was generally successful, with the Chinese endorsing a limited defensive buildup and stronger US ties. Publicly and privately, the Chinese continue to express understanding of Tokyo's view of the Soviet threat. [REDACTED]

The recent increase in tension stemming from conflicting security policies is taking place against a backdrop of continued acrimony over the so-called "Northern Territories." Nakasone has made it clear that there can be no major improvement in either political or economic relations until all four of the disputed islands are returned to Japan, something that the USSR has consistently refused to do. [REDACTED]

--continued

[REDACTED]

Maintaining a Dialogue

Despite the increasing tension, both sides have displayed an interest in maintaining contacts. Nakasone believes it is imperative to keep channels of communication open to Japan's principal adversary. Moscow hopes to entice Japanese businessmen to put pressure on Tokyo to relax adherence to Western restrictions on trading with the USSR. [REDACTED]

In mid-February Fisheries Minister Kamentsev became the first Soviet minister to make an official visit to Japan since the invasion of Afghanistan. In late February a 250-member business delegation visited Moscow. Little substantive progress was made during these exchanges, but Soviet-Japanese dialogue will continue. [REDACTED]

The Japanese will host the annual Soviet-Japanese administrative-level talks in early April. Another Japanese business delegation will visit the USSR in June. [REDACTED]

Outlook

The public controversy over security issues may abate somewhat in the near future. Conservative leaders in Tokyo face a series of elections in the next few months and believe the current degree of public anxiety over security policy is not to their advantage. As a result, Nakasone has agreed to focus on more politically rewarding domestic issues. [REDACTED]

Moreover, the Japanese are interested in preventing the relationship from sliding further. The Soviets maintain an interest in involving Japanese industry in trade and Siberian development, and they may tone down their rhetoric to improve the atmosphere. [REDACTED]

Nonetheless, there is little prospect for any measurable improvement in bilateral relations. Moscow is likely to pursue a hard line against Japan throughout the region as long as Tokyo maintains its current policies on defense and the Northern Territories. [REDACTED]

